

**AUDITED FINANCIAL STATEMENTS**

**TETRAGON FINANCIAL GROUP LIMITED**

**FOR THE YEAR ENDED 31 DECEMBER 2013**

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**TETRAGON FINANCIAL GROUP LIMITED**

**AUDITED FINANCIAL STATEMENTS**

**For the year ended 31 December 2013**

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# **TETRAGON FINANCIAL GROUP LIMITED**

## **DIRECTORS' REPORT** **For the year ended 31 December 2013**

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The Directors present to the shareholders their report together with the audited financial statements for the year ended 31 December 2013.

### **THE COMPANY**

Tetragon Financial Group Limited (the "Company") was registered in Guernsey on 23 June 2005 as a company limited by shares, with registered number 43321. All voting shares of the Company are held by Polygon Credit Holdings II Limited (the "Voting Shareholder"). The Company continues to be registered and domiciled in Guernsey, and the Company's Shares are listed on the NYSE Euronext Amsterdam Exchange.

The Company acts as a feeder fund in a "master feeder structure" investing substantially all of its assets in Tetragon Financial Group Master Fund Limited (the "Master Fund").

The Company aims to provide stable returns to investors across various credit, equity, interest rate and real estate cycles, and maintains two key business segments: an investment portfolio and an asset-management platform. Both segments cover a broad range of assets including bank loans, real estate, equities, credit and convertible bonds. The Company currently invests primarily through long-term funding vehicles such as collateralized loan obligations.

The Company's asset-management platform ("TFG Asset Management") currently consists of Polygon Global Partners LP and Polygon Global Partners LLP (collectively with certain affiliates, "Polygon"), LCM Asset Management LLC ("LCM") and GreenOak Real Estate, LP ("GreenOak"). TFG Asset Management L.P. is registered as an investment adviser under the U.S. Investment Advisers Act of 1940 (the "Advisers Act") and one of its investment management entities, Polygon Global Partners LLP, is authorised and regulated by the United Kingdom Financial Conduct Authority.

### **INVESTMENT OBJECTIVE**

The Company's investment objective is to generate distributable income and capital appreciation. To achieve this objective, Tetragon Financial Management LP (the "Investment Manager") seeks to identify opportunities, assets and asset classes it believes to be attractive and asset managers it believes to be superior based on their track record and expertise. It also seeks to use the market experience of the Investment Manager to negotiate favorable transactions and terms for its investments in asset classes and in asset managers. As part of this current investment strategy, the Investment Manager may employ hedging strategies and leverage in seeking to provide attractive returns while managing risk.

### **RESULTS, ACTIVITIES AND FUTURE DEVELOPMENTS**

The results of operations are set out on pages 9 to 10. A detailed review of activities and future developments is contained in the Investment Manager's Report issued with these financial statements to the Shareholders.

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## TETRAGON FINANCIAL GROUP LIMITED

### DIRECTORS' REPORT (continued) For the year ended 31 December 2013

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#### DIRECTORS

The Directors who held office during the year and up to the date of this report were:

Paddy Dear  
Rupert Dorey\*  
Reade Griffith  
David Jeffreys\*  
Byron Knief\*  
Greville Ward\*

\* Independent non-executive Directors

The remuneration for Directors is determined by resolution of the Voting Shareholder. Each of the Directors' annual fee is US\$ 75,000 in compensation for service on the Boards of Directors of both the Company and the Master Fund, which is paid by the Master Fund. Paddy Dear and Reade Griffith have waived their entitlement to a fee in respect of their services as Directors.

The Directors are entitled to be repaid by the Company for all travel, hotel and other expenses reasonably incurred by them in the discharge of their duties. None of the Directors has a contract with the Company or the Master Fund providing for benefits upon termination of employment.

#### SECRETARY

State Street (Guernsey) Limited held the office of Secretary throughout the year and up to the date of this report.

#### DIVIDENDS

The Board of Directors has the authority to declare dividend payments, based upon the recommendation of the Investment Manager, subject to the approval of the voting shares of the Company and adherence to applicable law including the satisfaction of a solvency test as stated under The Companies (Guernsey) Law, 2008. The Investment Manager's recommendation with respect to the declaration of dividends (and other capital distributions) may be informed by a variety of considerations, including (i) the expected sustainability of the Company's cash generation capacity in the short and medium term, (ii) the current and anticipated performance of the Company, (iii) the current and anticipated operating and economic environment and (iv) other potential uses of cash ranging from preservation of the Company's investments and financial position to other investment opportunities. The Directors declared a dividend amounting to US\$ 0.135 per share for the Quarter Ended 31 December 2012, US\$ 0.135 per share for the Quarter Ended 31 March 2013, US\$ 0.14 for the Quarter Ended 30 June 2013 and US\$ 0.14 for the Quarter Ended 30 September 2013. The total dividend declared during the year ended 31 December 2013 amounted to US\$ 53.9 million or US\$ 0.55 per share (31 December 2012: US\$ 50.3 million or US\$ 0.44 per share). On 26 February, the Directors have declared a dividend US\$ 0.15 for the Quarter Ended 31 December 2013.

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## **TETRAGON FINANCIAL GROUP LIMITED**

### **DIRECTORS' REPORT (continued) For the year ended 31 December 2013**

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#### **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

The Companies (Guernsey) Law, 2008 requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in conformity with U.S. generally accepted accounting principles ("U.S. GAAP") and applicable law.

The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing those financial statements the Directors are required to:

- Select suitable accounting policies and apply them consistently;
- Make judgments and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping of proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with The Companies (Guernsey) Law, 2008. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website.

The Guernsey Financial Services Commission ("GFSC") has issued a Code of Corporate Governance (the "Code") which provides a framework that applies to all entities licensed by the GFSC or which are registered or authorised as a collective investment scheme under the Protection of Investors (Bailiwick of Guernsey) Law, 1987. In conformity with the Code, the Company has prepared a self-assessment reflecting its nature, scale and complexity in order to assist the Directors in their annual consideration of the Code.

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## **TETRAGON FINANCIAL GROUP LIMITED**

### **DIRECTORS' REPORT (continued) For the year ended 31 December 2013**

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#### **STATEMENT OF DIRECTORS' RESPONSIBILITIES (continued)**

The Directors confirm that we have complied with the above requirements in preparing the financial statements and that to the best of our knowledge and belief:

- This annual report includes a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that the Company faces; and
- The financial statements, prepared in conformity with U.S. GAAP give a true and fair view of the assets, liabilities, financial position, results and cash flows of the Company.

#### **DISCLOSURE OF INFORMATION TO AUDITOR**

So far as each of the Directors is aware, there is no relevant audit information of which the Company's auditor is unaware, and each has taken all the steps he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

#### **AUDITORS**

KPMG has been appointed as independent auditors to perform a non-statutory audit of the Company for certain regulatory purposes and they have expressed their willingness to continue in office.

Signed on behalf of the Board of Directors by:

Rupert Dorey, Director  
David Jeffreys, Director

Date: 26 February 2014

## **Independent Auditor's Report**

The Board of Directors  
Tetragon Financial Group Limited

We have audited the accompanying financial statements of Tetragon Financial Group Limited (the "Company"), which comprise the statements of assets and liabilities as of December 31, 2012 and 2013, and the related statements of operations, statements of changes in net assets and statements of cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of the Company as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG  
1 Harbourmaster Place  
IFSC  
Dublin 1  
Ireland  
February 26, 2014

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**TETRAGON FINANCIAL GROUP LIMITED**

**STATEMENTS OF ASSETS AND LIABILITIES**

**As at 31 December 2013**

	Note	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
<b>Assets</b>			
Investment in the Master Fund	3	1,846,731	1,658,276
<b>Total assets</b>		1,846,731	1,658,276
<b>Liabilities</b>			
Accrued incentive fee	6	32,850	30,227
Amounts payable on share options	5	10,669	6,601
<b>Total liabilities</b>		43,519	36,828
<b>Net assets</b>		1,803,212	1,621,448
<b>Equity</b>			
Share capital	7	99	99
Share premium	8	963,224	964,966
Capital reserve in respect of share options	9	11,789	11,789
Share based employee compensation reserve	4	17,602	3,849
Retained earnings	12	810,498	640,745
		1,803,212	1,621,448
<b>Shares outstanding</b>			
		<b>Number '000</b>	<b>Number '000</b>
Shares	7	98,938	98,805
<b>Net Asset Value per share</b>		US\$ 18.23	US\$ 16.41

The accompanying notes are an integral part of the financial statements.

Signed on behalf of the Board of Directors by:

Rupert Dorey, Director

David Jeffreys, Director

Date: 26 February 2014

**TETRAGON FINANCIAL GROUP LIMITED**

**STATEMENTS OF OPERATIONS**  
For the year ended 31 December 2013

	Note	Year ended 31 Dec 2013 US\$ '000	Year ended 31 Dec 2012 US\$ '000
<b>Investment income allocated from the Master Fund</b>			
Interest income		204,779	235,596
Fee income		74,336	36,704
Dividend income		80	-
Other income – cost recovery		21,101	6,773
<b>Total investment income allocated from the Master Fund</b>		<u>300,296</u>	<u>279,073</u>
<b>Direct expenses</b>			
Incentive fee	6	(64,893)	(86,219)
<b>Total direct expenses</b>		<u>(64,893)</u>	<u>(86,219)</u>
<b>Operating expenses allocated from the Master Fund</b>			
Employee costs		(49,942)	(23,564)
Management fees	9	(25,124)	(21,022)
Share based employee compensation	4	(23,096)	(3,849)
Legal and professional fees		(9,148)	(12,369)
Audit fees		(374)	(376)
Other operating and administrative expenses		(25,339)	(8,791)
<b>Total operating expenses allocated from the Master Fund</b>		<u>(133,023)</u>	<u>(69,971)</u>
<b>Total operating expenses</b>		(197,916)	(156,190)
<b>Net investment income</b>		<u>102,380</u>	<u>122,883</u>
<b>Net increase in unrealized depreciation on:</b>			
Share options	5	(4,068)	(5,022)
<b>Net increase in unrealized depreciation arising from direct operations</b>		<u>(4,068)</u>	<u>(5,022)</u>
<b>Net realized and unrealized gain from investments and foreign currency allocated from the Master Fund</b>			
Net realized gain / (loss) from:			
Investments		10,451	5,334
Derivative financial instruments		6,728	(15,820)
Foreign currency transactions		(5,259)	5,561
		<u>11,920</u>	<u>(4,925)</u>

**TETRAGON FINANCIAL GROUP LIMITED**

**STATEMENTS OF OPERATIONS (continued)**

**For the year ended 31 December 2013**

	<b>Note</b>	<b>Year ended 31 Dec 2013 US\$ '000</b>	<b>Year ended 31 Dec 2012 US\$ '000</b>
<b>Net increase in unrealized appreciation on:</b>			
Investments		106,137	191,275
Derivative financial instruments		7,838	1,079
Translation of assets and liabilities in foreign currencies		8,856	2,359
		122,831	194,713
<b>Net realized and unrealized gain from investments and foreign currencies allocated from the Master Fund</b>			
		134,751	189,788
Bargain purchase		-	54,774
<b>Net increase from operations before tax</b>			
		233,063	362,423
Income and deferred tax expense		(8,796)	(3,574)
<b>Net income</b>			
		224,267	358,849
<b>Net income attributable to:</b>			
Owners of the Company		224,267	357,158
Noncontrolling interest		-	1,691
		224,267	358,849
<b>Earnings per share</b>			
Basic	11	US\$ 2.29	US\$ 3.15
Diluted	11	US\$ 2.05	US\$ 2.85
<b>Weighted average Shares outstanding</b>			
Basic	11	98,017	113,347
Diluted	11	109,311	125,183

The accompanying notes are an integral part of the financial statements.

**TETRAGON FINANCIAL GROUP LIMITED**

**STATEMENTS OF CHANGES IN NET ASSETS**

**For the year ended 31 December 2013**

	Note	Year ended 31 Dec 2013 US\$ '000	Year ended 31 Dec 2012 US\$ '000
From operations:			
Total investment income		300,296	279,073
Total operating expenses		(197,916)	(156,190)
Net unrealized depreciation on share options		(4,068)	(5,022)
Net realized gain / (loss) from investments and foreign currency allocated from the Master Fund		11,920	(4,925)
Net unrealized gain from investments and foreign currency allocated from the Master Fund		122,831	194,713
Bargain purchase		-	54,774
Income and deferred tax expense		(8,796)	(3,574)
Attributed to noncontrolling interest		-	(1,691)
Net income		<u>224,267</u>	<u>357,158</u>
Share based employee compensation	4	23,096	3,849
<b>Net increase in net assets resulting from operations</b>		<u>247,363</u>	<u>361,007</u>
Dividends paid to shareholders	10	(53,922)	(50,296)
Issue of Shares	7	4,395	11,994
Purchase of Treasury Shares	7	(16,072)	(175,612)
<b>Decrease in net assets resulting from net share transactions</b>		<u>(11,677)</u>	<u>(163,618)</u>
<b>Total increase in net assets</b>		181,764	147,093
Net assets at start of year		1,621,448	1,474,355
<b>Net assets at end of year</b>		<u><u>1,803,212</u></u>	<u><u>1,621,448</u></u>

The accompanying notes are an integral part of the financial statements.

**TETRAGON FINANCIAL GROUP LIMITED**

**STATEMENTS OF CASH FLOWS**  
**For the year ended 31 December 2013**

	<b>Year ended 31 Dec 2013 US\$ '000</b>	<b>Year ended 31 Dec 2012 US\$ '000</b>
<b>Operating activities</b>		
Net income	224,267	357,158
Adjustments for:		
Net unrealized depreciation on share options	4,068	5,022
Share based employee compensation reserve	23,096	3,849
Net unrealized appreciation on investments in the Master Fund	(188,455)	(159,117)
Operating cash flows before movements in working capital	62,976	206,912
Decrease in receivables	-	460
Increase in payables	2,623	7,002
<b>Net cash provided by operating activities</b>	65,599	214,374
<b>Financing activities</b>		
Issue of Shares	4,395	11,994
Purchase of Treasury Shares	(16,072)	(176,072)
Dividends paid to shareholders	(53,922)	(50,296)
<b>Net cash used in financing activities</b>	(65,599)	(214,374)
<b>Net increase in cash and cash equivalents</b>	-	-
Cash and cash equivalents at beginning of year	-	-
<b>Cash and cash equivalents at end of year</b>	-	-

The accompanying notes are an integral part of the financial statements.

## TETRAGON FINANCIAL GROUP LIMITED

### FINANCIAL HIGHLIGHTS For the year ended 31 December 2013

The following represents selected per Share operating performance of the Company, ratios to average net assets and total return information for the year ended 31 December 2013 and the year ended 31 December 2012.

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$</b>	<b>US\$</b>
<b>Per Share operating performance</b>		
Net Asset Value at the start of the year	16.41	12.71
Net investment income (excluding incentive fee)	1.71	1.88
Incentive fee	(0.66)	(0.76)
Net realized and unrealized gain from investments and foreign currencies	1.33	1.63
Bargain purchase	-	0.48
Share based employee compensation	0.24	0.03
Dividends paid to shareholders	(0.55)	(0.44)
Income and deferred tax expense and noncontrolling interest	(0.09)	(0.04)
Other capital transactions	(0.16)	0.92
Net Asset Value at the end of the year	18.23	16.41
<b>Pro Forma Fully Diluted NAV per Share</b>		
	<b>Shares '000</b>	<b>Shares '000</b>
Shares outstanding	98,938	98,805
Shares held in escrow	11,281	11,836
Dilutive effect of Share options granted to Investment Manager	13	-
Pro Forma Fully Diluted Shares	110,232	110,641
Pro Forma Fully Diluted Net Asset Value per Share	US\$ 16.36	US\$ 14.65
Total return (NAV change excluding dividends and other capital transactions) before incentive fee	19.40%	38.61%
Incentive fee	(4.03%)	(6.00%)
Total return (NAV change excluding dividends and other capital transactions) after incentive fee	15.37%	32.61%
<b>Ratios and supplemental data</b>		
Ratio to average net assets:		
Operating expenses allocated from the Master Fund	6.52%	3.95%
Total operating expenses	6.52%	3.95%
Incentive fee	3.85%	5.46%
Net investment income	6.07%	8.03%
An individual shareholder's per Share operating performance and ratios may vary from the above based on the timing of capital transactions.		

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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2013

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#### **Note 1     General Information**

The Company was registered in Guernsey on 23 June 2005 as a company limited by shares with registered number 43321. All voting shares of the Company are held by Polygon Credit Holdings II Limited. The Company continues to be registered and domiciled in Guernsey, and the Company's Shares are listed on the NYSE Euronext Amsterdam Exchange.

The registered office of the Company is 1<sup>st</sup> Floor Dorey Court, Admiral Park, St. Peter Port, Guernsey, Channel Islands, GY1 6HJ.

The Company's non-voting shares (referred to herein as the "Shares") are listed on the NYSE Euronext in Amsterdam Exchange.

#### **Note 2     Significant Accounting Policies**

##### **Basis of Presentation**

The financial statements give a true and fair view, are prepared in conformity with U.S. GAAP and comply with The Companies (Guernsey) Law, 2008.

The Company's investment in the Master Fund is valued based on the Net Asset Value ("NAV") per share obtained from the Master Fund's Administrator, which is the Company's interest in the Net Assets of the Master Fund. The performance of the Company is directly affected by the performance of the Master Fund.

The Company's Statements of Operations includes its allocated share of each type of gain, loss, income and expense of the Master Fund's Statements of Operations. Attached are the audited consolidated financial statements of the Master Fund, which are an integral part of these financial statements. As at 31 December 2013, the Company had 100% (31 December 2012: 100%) ownership interest in the Master Fund. As the Company owns 100% of the Master Fund and the audited consolidated financial statements of the Master Fund are attached, a separate Schedule of Investments for the Company has not been included.

For financial statement reporting purposes, the Company is an investment company and follows the measurement guidance set out in ASC 946, Financial Services – Investment Companies.

Except for new standards adopted, the accounting policies have been consistently applied by the Company during the year ended 31 December 2013 and are consistent with those used in the previous year.

The financial statements are presented in United States Dollars and rounded to the nearest thousand.

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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### Note 2 Significant Accounting Policies (continued)

##### Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes, including the valuation of investments. The Company's management believes that the estimates utilized in preparing the financial statements are reasonable and prudent. Actual results could differ materially from these estimates.

##### Valuation of Investments

The value of the investment in the Master Fund is based on the NAV per share obtained from the Master Fund's Administrator.

##### Expenses

Expenses are recognized in the Statements of Operations on an accruals basis.

##### Taxation

The Company is exempt from Guernsey income tax under the Income Tax (Exempt Bodies) (Guernsey) Ordinance 1989 and is charged GBP 600 per annum.

In accordance with ASC Subtopic 740-10 – Income Taxes – Overall, the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. There were no uncertain tax positions recognized at 31 December 2013.

##### Share Options

The fair value of the options granted to the Investment Manager at the time of the Company's initial public offering in 2007, was recognized as a charge to a reserve in respect of the share options, over the year in which the Investment Manager became unconditionally entitled to the options. The options were fully vested and immediately exercisable from the date of the grant, on 26 April 2007 and remain exercisable for ten years.

The fair value of options issued to certain founding partners of GreenOak are recognized as a liability in the Statements of Assets and Liabilities, as the options contain certain other performance conditions. Any subsequent change in the fair value is recognized through the Statements of Operations.

##### Dividend Expense

Dividend expense from Shares are recognized in the Statements of Changes in Net Assets.



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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### **Note 2 Significant Accounting Policies (continued)**

##### **Share Based Payments**

Share-based compensation expense for all equity settled share-based payment awards granted is determined based on the grant-date fair value. The Company recognizes these compensation costs net of an estimated forfeiture rate, and recognizes compensation cost only for those Shares expected to meet the service and performance vesting conditions, on a straightline basis over the requisite service period of the award. These compensation costs are determined at the aggregate grant level for service-based awards and at the individual vesting tranche level for awards with performance conditions.

When the Shares are actually issued the fair value of the Shares, as determined at the time of the award, is debited against the share based employee compensation reserve. Any associated stock dividends accrued on the original award are debited against retained earnings and credited to share capital and share premium using the value determined by the stock reference price at the date of each applicable dividend.

##### **Treasury Shares**

When share capital recognized as equity is repurchased the amount of the consideration paid, which includes directly attributable costs, is recognized as a deduction from equity. Repurchased Shares may be classified as treasury Shares from an accounting perspective and are presented as a deduction from total equity. When treasury Shares are sold or reissued subsequently, the amount received is recognized as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to or from retained earnings. Shares may also be transferred out of the Treasury Account and into a wholly owned subsidiary. Where this occurs the status of the Shares is unchanged from an accounting perspective and they are not included in the Shares outstanding on the Statements of Assets and Liabilities.

#### **Note 3 Investment in Master Fund**

At the year end, the Master Fund held investments at fair value, cash and cash equivalents, derivatives and other receivables and payables.

As at 31 December 2013, the Company had an investment of US\$ 1,846.7 million in the Master Fund (31 December 2012: US\$ 1,658.3 million).

#### **Note 4 Share Based Payments**

Polygon Management L.P. (now known as TFG Asset Management L.P.) and certain of its affiliates, including Polygon's asset management businesses and infrastructure platform, along with Polygon's interests in LCM and GreenOak, were acquired on 28 October 2012 (the "Acquisition"), in exchange for consideration of approximately 11.7 million non-voting Shares to the sellers subject to certain vesting and forfeiture conditions (the "Aggregate Consideration"). The Aggregate Consideration shall be held in escrow (along with accrued stock dividends) until it is released over the period 2013 to 2017.

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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### **Note 4 Share Based Payments (continued)**

Under ASC 805 - Business Combinations ("ASC 805") these Shares are treated as payment for post combination services rather than upfront consideration, hence the initial consideration is determined to be nil, resulting in a bargain purchase. The expense is recognized in the Master Fund through the Statements of Operations, as well as reflecting the assets acquired and a reserve to reflect the capital contribution of the Shares from the Company. The Company has a share based compensation reserve and recognizes the expense indirectly as allocated from the Master Fund. The charge for the year ended 31 December 2013 amounted to US\$ 23.1 million (31 December 2012: US\$ 3.8 million).

#### **Note 5 Share Options Issued to GreenOak**

On 16 September 2010, the Master Fund entered into a transaction with GreenOak whereby it received a 10% equity interest in GreenOak and agreed to provide, among other things, a working capital loan of up to US\$ 10.0 million and a US\$ 100.0 million co-investment commitment that is expected to fund up to a limited fixed percentage of any GreenOak sponsored investment program, with the Master Fund retaining the option to invest further amounts.

Under the terms of the transaction, the Company granted to the GreenOak founding partners ("Founders") options to purchase 3.9 million Shares (exercisable after 5 years and subject to further conditions) at a strike price of US\$ 5.50. The aggregate fair value of the options granted at the transaction date was US\$ 0.5 million. In order to reflect some key vesting requirements of the options which are not captured by the Black-Scholes model a 50% haircut was applied to the initial calculated valuation. This was derived as follows: restriction on transferability – 25%; requirement to repay working capital loan – 10%; exclusivity of Founders – 15%. These have been reviewed on a regular basis and as at 31 December 2013, the restriction on transferability is 10%, the requirement to repay the working capital loan is 5% and the exclusivity of Founders is 5%, reflecting the fact that the options are closer to their exercise dates. After this adjustment the haircut stands at 20%.

The options are split approximately as follows: 50% exercisable 5 years after transaction date and expiring a year later; 25% exercisable 6 years after transaction date and expiring a year later; 25% exercisable 7 years after transaction date and expiring a year later.

At 31 December 2013, the fair value of the options was US\$ 10.7 million (31 December 2012: US\$ 6.6 million).

#### **Note 6 Incentive Fee**

The Company pays the Investment Manager an incentive fee for each Calculation Period (a period of three months ending on 31 March, 30 June, 30 September and 31 December in each year or as otherwise determined by the Directors) equal to 25% of the increase in the NAV of the Company during the Calculation Period (before deduction of any dividend paid or the amount of any redemptions or repurchases of the Shares (or other relevant capital adjustments) during such Calculation Period) above the Reference NAV (as defined below) plus the Hurdle (as defined below) for the Calculation Period. If the Hurdle is not met in any Calculation Period (and no incentive fee is paid), the shortfall will not carry forward to any subsequent Calculation Period.

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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### **Note 6 Incentive Fee (continued)**

The “Hurdle” for any Calculation Period will equal the Reference NAV multiplied by the Hurdle Rate (as defined below). The Hurdle Rate for any Calculation Period equals 3-month USD LIBOR determined as of 11:00 a.m. London time on the first London business day of the then current Calculation Period, plus the Hurdle Spread of 2.647858% in each case multiplied by the actual number of days in the Calculation Period divided by 365.

The “Reference NAV” is the greater of (i) NAV at the end of the Calculation Period immediately preceding the current Calculation Period and (ii) the NAV as of the end of the Calculation Period immediately preceding the Calculation Period referred to in clause (i). For the purpose of determining the Reference NAV at the end of a Calculation Period, NAV shall be adjusted by the amount of accrued dividends and the amounts of any redemptions or repurchase of the Shares (or other relevant capital adjustments) and incentive fees to be paid with respect to that Calculation Period.

The incentive fee in respect of each Calculation Period is calculated by reference to the NAV before deduction of any accrued incentive fee. If the Investment Management Agreement is terminated other than at the end of a Calculation Period, the date of termination will be deemed to be the end of the Calculation Period. The incentive fee is normally payable in arrears after the end of the Calculation Period.

The incentive fee for the year ended 31 December 2013 was US\$ 64.9 million (31 December 2012: US\$ 86.2 million). As at 31 December 2013, US\$ 32.9 million was outstanding (31 December 2012: US\$ 30.2 million).

#### **Note 7 Share Capital**

##### **Authorized**

The Company has an authorized share capital of US\$ 1.0 million divided into 10 voting shares, having a par value of US\$ 0.001 each and 999,999,990 non-voting Shares, each having a par value of US\$ 0.001 each. Shares are issuable either as certificated shares or uncertificated shares, and in both cases as registered shares in accordance with applicable law.

##### **Voting Shares**

The 10 voting shares in issue were issued at par and are owned by the Voting Shareholder, which is a non-U.S. affiliate of the Investment Manager.

The voting shares are the only shares of the Company entitled to vote for the election of Directors and on all other matters put to a vote of shareholders, subject to the limited rights of the Shares described below. The voting shares are not entitled to receive dividends.

##### **Shares**

The Shares are not entitled to vote on any matter other than limited voting rights in respect of variation of their class rights. The Shares carry a right to any dividends or other distributions declared by the Company. The Shares are subject to certain transfer restrictions as set out in the Company’s Memorandum and Articles of Incorporation.

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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### Note 7 Share Capital (continued)

##### Shares (continued)

The Directors, upon the recommendation of the Investment Manager and with prior approval of a resolution of voting shares, may allot, issue or otherwise dispose of Shares to such persons, at such times, for such consideration and on such terms and conditions as they deem necessary or desirable. There are no pre-emption rights attaching to any Shares.

The Directors, upon the recommendation of the Investment Manager, may grant options over the Shares. The Company may repurchase Shares and hold such repurchased Shares as Treasury Shares.

##### Share Transactions

	Voting Shares No.	Shares No. '000	Shares US\$ '000
Shares in issue at 31 December 2011	10	115,968	116
Issued in lieu of stock dividend	-	1,530	2
Treasury Shares purchased during the year	-	(18,693)	(19)
Shares in issue at 31 December 2012	10	98,805	99
Issued in lieu of stock dividend	-	413	-
Issued through release of tranche of Escrow Shares	-	1,165	1
Treasury Shares purchased during the year	-	(1,445)	(1)
Shares in issue at 31 December 2013	10	98,938	99

##### Optional Stock Dividend

The Company has an Optional Stock Dividend Plan which offers investors an opportunity to elect to receive any declared dividend in the form of dividend shares at a reference price determined by calculating the five-day weighted average price post ex-dividend date.

During the year a total dividend of US\$ 53.9 million (31 December 2012: US\$ 50.3 million) was declared, of which US\$ 49.5 million was paid out as a cash dividend (31 December 2012: US\$ 38.3 million), and the remaining US\$ 4.4 million (31 December 2012: US\$ 12.0 million) was reinvested under the Optional Stock Dividend Plan.

##### Treasury Shares

The Company owns a subsidiary, TFG Holdings I, to which it may transfer, and has transferred, Shares previously held in a Treasury Account. Where this occurs the status of the Shares is unchanged from an accounting perspective and they are not included in the Shares outstanding on the Statements of Assets and Liabilities.

On 30 November 2007, the Company announced the implementation of a share repurchase program ("Program") of their outstanding Shares. This was renewed on several occasions, most recently on 14 January 2013 running until 30 April 2013 when it expired. As at 31 December 2013 there was no share repurchase program in place.

# TETRAGON FINANCIAL GROUP LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

### Note 7 Share Capital (continued)

#### Treasury Shares (continued)

When the Program was in operation, the Master Fund had undertaken to repurchase an identical number of its own shares from the Company as and when it made these repurchases in the open market.

The Master Fund matched the price per share paid by the Company. The shares are held in a Treasury Account or in a subsidiary, allowing them to potentially be resold back to the Company if it resells its own Shares back into the market at a later date. Whilst they are held by the Master Fund (whether directly or via a subsidiary), the Shares are neither eligible to receive dividends nor are they included in the Shares outstanding on the Statements of Assets and Liabilities.

As at 31 December 2013, 16.6 million Shares are held in TFG Holdings I (31 December 2012: 16.6 million) and 7.9 million Shares in the Treasury Account (31 December 2012: 6.5 million), with an aggregate attributed cost of US\$ 210.1 million (31 December 2012: US\$ 194.0 million).

	<b>Treasury Shares</b>	<b>Shares held in subsidiary</b>
	<b>Shares</b>	<b>Shares</b>
	<b>No. '000</b>	<b>No. '000</b>
Shares brought forward at 31 December 2011	7,577	8,523
Treasury Shares purchased during the year	18,693	-
Shares transferred to subsidiary	(15,385)	15,385
Shares contributed in connection with the Acquisition	(4,382)	(7,304)
Treasury Shares at 31 December 2012	6,503	16,604
Treasury Shares purchased during the year	1,445	-
Treasury Shares at 31 December 2013	7,948	16,604

### Note 8 Share Premium

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Balance at start of year	964,966	1,128,567
Premium arising on issuance of Shares	14,329	11,992
Discount arising from purchase of Shares	(16,071)	(175,593)
Balance at end of year	963,224	964,966

### Note 9 Related Party Transactions

The Investment Manager is entitled to receive management fees equal to 1.5% per annum of the Net Asset Value of the Company payable monthly in advance prior to the deduction of any accrued incentive fee. All fees and expenses of the Company including the Management and Administration fees, but excluding incentive fees from the Investment Manager, are paid by the Master Fund and allocated fully to the Company. An incentive fee may be paid to the Investment Manager as disclosed in Note 6.

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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### Note 9 Related Party Transactions (continued)

In recognition of the work performed by the Investment Manager in successfully arranging the global offering and the associated raising of new capital for the Company, in 2007 the Company granted to the Investment Manager options (the "Investment Management Options") to purchase approximately 12.5 million of the Company's Shares (before any application of potential anti-dilution) at an exercise price per share equal to the Offer Price (US\$ 10.00). The Investment Management Options were fully vested and immediately exercisable on the date of admission to the NYSE Euronext in Amsterdam exchange and will remain exercisable until the 10th anniversary of that date. The aggregate fair value of the options granted at the time of the global offering was US\$ 11.8 million. The fair value of each option granted during 2007 was US\$ 0.94 on the date of grant using the Binomial-pricing model with the following average assumptions: expected dividend yield 8%, risk-free interest rate of 5.306%, an expected life of 5 years and a volatility of 17.5%.

The Company invests substantially all of its assets in the Master Fund, a Guernsey based closed-ended investment company which has the same Investment Manager as the Company.

The remuneration for Directors shall be determined by resolution of the Voting Shareholder. Each of the Directors' annual fee is US\$ 75,000 in compensation for service on the Boards of Directors of both the Company and the Master Fund. The Master Fund will pay the Directors' fees. Paddy Dear and Reade Griffith have waived their entitlement to a fee in respect of their services as Directors. The Directors are entitled to be repaid by the Company all travel, hotel and other expenses reasonably incurred by them in the discharge of their duties. None of the Directors has a contract with the Company or the Master Fund providing for benefits upon termination of employment.

The Voting Shareholder is an affiliate of the Investment Manager and holds all of the voting shares. As a result of its ownership and the degree of control that it exercises, the Voting Shareholder will be able to control the appointment and removal of the Company's Directors (subject to applicable law). Affiliates of the Voting Shareholder also control the Investment Manager and, accordingly, control the Company's business and affairs.

Paddy Dear, Reade Griffith, and Rupert Dorey - all Directors of the Company and the Master Fund – maintained (directly or indirectly) interests in Shares of the Company as at 31 December 2013, with interests of 386,413, 1,186,209 and 92,311 Shares respectively (31 December 2012: 310,218, 1,036,209 and 88,940 Shares respectively). Messrs, Griffith and Dear also have a (direct or indirect) interest in the Escrow Shares (as defined below).

As described in Note 4 Polygon Management L.P. (now known as TFG Asset Management L.P.), including Polygon's asset management businesses and infrastructure platform, and interests in LCM and GreenOak, was acquired on 28 October 2012. The Shares issued in consideration are subject to vesting and forfeiture conditions and will be held in escrow until they vest over the period 2013 to 2017. These escrow Shares are eligible to participate in the optional stock dividend program, and as a result of subsequent dividends, further Shares were added to the relevant escrow accounts. As part of the Acquisition, Messrs. Griffith and Dear, as founders of Polygon, were awarded consideration in Shares which would vest between 2015 and 2017.

In particular, Messrs. Griffith and Dear, were initially allocated 5,539,954 and 1,955,291 Shares, respectively, and these are currently held in escrow pending release between 2015 and 2017. As at 31 December 2013, 5,908,198 Shares were held in escrow on behalf of Mr. Griffith and 2,085,254 on behalf of Mr. Dear.

**TETRAGON FINANCIAL GROUP LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**For the year ended 31 December 2013**

**Note 9 Related Party Transactions (continued)**

It was also contractually agreed at the time of the Acquisition that they would be entitled to total annual compensation in respect of their executive role with the Company and its subsidiaries totaling not more than US\$ 100,000 each. During the year ended 31 December 2013 total compensation paid to them each in this capacity by the Master Fund in aggregate was US\$ 100,000.

**Note 10 Dividends**

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Quarter ended 31 December 2011 of US\$ 0.105 per share	-	12,080
Quarter ended 31 March 2012 of US\$ 0.105 per share	-	12,073
Quarter ended 30 June 2012 of US\$ 0.115 per share	-	13,079
Quarter ended 30 September 2012 of US\$ 0.115 per share	-	13,064
Quarter ended 31 December 2012 of US\$ 0.135 per share	13,266	-
Quarter ended 31 March 2013 of US\$ 0.135 per share	13,159	-
Quarter ended 30 June 2013 of US\$ 0.14 per share	13,661	-
Quarter ended 30 September 2013 of US\$ 0.14 per share	13,836	-
	53,922	50,296

The fourth quarter dividend of US\$ 0.15 per share was approved by the Directors on 26 February 2014 and has not been included as a liability in these financial statements.

**Note 11 Earnings per Share**

	<b>Year ended</b>	<b>Year ended</b>
	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
The calculation of the basic and diluted earnings per share is based on the following data:		
Earnings for the purposes of basic earnings per share being net profit attributable to shareholders for the year	224,265	357,158
Weighted average number of Shares for the purposes of basic earnings per share	98,017	113,347
Effect of dilutive potential Shares:		
Share based employee compensation	11,281	11,836
Share options	13	-
Weighted average number of Shares for the purposes of diluted earnings per share	109,311	125,183

Diluted earnings per share is calculated by adjusting the weighted average number of Shares outstanding assuming conversion of all potential dilutive Shares. Share options and share based employee compensation are potential dilutive Shares.

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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### Note 11 Earnings per Share (continued)

In respect of share based employee compensation, it is assumed that all of the Shares currently held in escrow will be released, thereby increasing the weighted average number of Shares. This includes Shares which are scheduled to vest and be released between 2014 and 2017.

In respect of share options, the intrinsic value of the Shares issued to the Investment Manager in connection with the global offering in 2007 (see Note 9) is calculated using the Company's quoted Share price on the last business day prior to the year end. This is then converted into a number of Shares by dividing the aforementioned intrinsic value by the aforementioned quoted Share price. This will yield the number of Shares to include in the dilution calculation.

In respect of share options issued to GreenOak, there was no dilution as the conditions on these options have not been met at the date of these financial statements.

#### Note 12 Retained Earnings

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Balance at start of year	640,745	333,883
Net increase in net assets resulting from operations for the year	224,267	357,158
Dividends paid	(53,922)	(50,296)
Stock dividends on Shares released from Escrow	(592)	-
Balance at end of year	<u>810,498</u>	<u>640,745</u>

#### Note 13 Other Matters

On 18 June 2013, a shareholder derivative action was filed in United States District Court – Southern District of New York – against the six directors of the Company and the Master Fund, the Investment Manager, the principals of the Investment Manager and other affiliated entities by a purported shareholder of the Company (the "Action").

The Action makes a series of allegations including with respect to the Acquisition (see Note 4) and asks, amongst other things, for money damages and equitable relief against the defendants, including the termination of the investment management agreement among the Company, the Master Fund and the Investment Manager.

The Company, the Master Fund and their Boards of Directors have stated that they believe that the Action is factually and legally without merit and intend to seek to have the Action dismissed as quickly as possible. On 13 January 2014, all defendants filed a motion to dismiss the Action in its entirety.

On 22 February 2011, the Company and the Master Fund and their six directors were served with proceedings in the Royal Court of Guernsey (the "Guernsey Proceedings") instigated by one of the Company's former directors, Alexander Jackson, seeking to impugn the Company's decision to enter into a joint venture with GreenOak.



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## TETRAGON FINANCIAL GROUP LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2013

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#### **Note 13 Other Matters (continued)**

On 26 March 2013, Lieutenant Bailiff Patrick Talbot of the Royal Court of Guernsey dismissed the Guernsey Proceedings having determined that the entire claim should be struck out as an abuse of process as no aspect of it satisfied the standard for bringing such a derivative action in Guernsey. Lieutenant Bailiff Talbot also awarded costs against Mr. Jackson. On 10 September 2013, the Court of Appeal of the Island of Guernsey ordered the discontinuance of Mr. Jackson's appeal of the Guernsey Proceedings, Mr. Jackson having paid costs of such appeal.

On 1 March 2013, the English Court of Appeal dismissed in its entirety a claim filed by Mr. Jackson against Paddy Dear and Reade Griffith in the High Court in London (the "English Proceedings") regarding Mr. Jackson's removal in January 2011 from the Board of Directors of the Company and the Master Fund and awarded costs against Mr. Jackson.

#### **Note 14 Subsequent Events**

On 10 February 2014 the Company and the Master Fund announced the commencement of a tender offer (the "Offer") to purchase a portion of the Shares of the Company for a maximum aggregate payment of US\$50.0 million in cash. The Offer will be conducted as a "modified Dutch auction" with Shareholders able to tender their Shares at prices ranging from US\$ 10.30 up to and including US\$ 11.50 per share (in increments of US\$0.10). The Offer is expected to expire at 11:59 p.m. Eastern Daylight Time on 10 March 2014, unless terminated earlier, is more fully described in the Offer to Purchase, which may be found on the Company's Website.

#### **Note 15 Recent Changes to U.S. GAAP**

In June 2013, the FASB issued ASU No. 2013-08, "Financial Services - Investment Companies (Topic 946) - Amendments to the Scope, Measurement, and Disclosure Requirements." ASU No. 2013-08 clarifies the approach to be used for determining whether an entity is an investment company and provides new measurement and disclosure requirements. ASU No. 2013-08 is effective for interim and annual reporting periods in fiscal years that begin after 15 December 2013. Earlier application is prohibited. Adoption of ASU No. 2013-08 is not expected to materially affect the Company's financial condition, results of operations, or cash flows.

#### **Note 16 Approval of Financial Statements**

The Directors approved the financial statements on 26 February 2014.

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**FOR THE YEAR ENDED 31 DECEMBER 2013**

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**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**For the year ended 31 December 2013**

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# TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

## DIRECTORS' REPORT For the year ended 31 December 2013

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The Directors present to the shareholders their report together with the audited consolidated financial statements for the year ended 31 December 2013.

### THE FUND

Tetragon Financial Group Master Fund Limited (the "Fund") was registered in Guernsey on 23 June 2005 as a company limited by shares, with registered number 43322. All voting shares of the Fund are held by Polygon Credit Holdings II Limited (the "Voting Shareholder"). The Fund continues to be registered and domiciled in Guernsey.

The Fund maintains two key business segments: an investment portfolio and an asset-management platform. Both segments cover a broad range of assets including bank loans, real estate, equities, credit and convertible bonds. The Fund currently invests primarily through long-term funding vehicles such as collateralized loan obligations.

The Fund's asset-management platform ("TFG Asset Management") currently consists of Polygon Global Partners LP and Polygon Global Partners LLP (collectively with certain affiliates, "Polygon"), LCM Asset Management LLC ("LCM") and GreenOak Real Estate LP, ("GreenOak"). TFG Asset Management L.P. is registered as an investment adviser under the U.S. Investment Advisers Act of 1940 and one of its investment management entities, Polygon Global Partners LLP, is authorised and regulated by the United Kingdom Financial Conduct Authority.

### INVESTMENT OBJECTIVE

The Fund's investment objective is to generate distributable income and capital appreciation. To achieve this objective, Tetragon Financial Management LP (the "Investment Manager") seeks to identify opportunities, assets and asset classes it believes to be attractive and asset managers it believes to be superior based on their track record and expertise. It also seeks to use the market experience of the Investment Manager to negotiate favourable transactions and terms for its investments in asset classes and in asset managers. As part of this current investment strategy, the Investment Manager may employ hedging strategies and leverage in seeking to provide attractive returns while managing risk.

### RESULTS, ACTIVITIES AND FUTURE DEVELOPMENTS

The results of operations are set out on page 8. A detailed review of activities and future developments is contained in the Annual Report issued with these consolidated financial statements to the Shareholders of Tetragon Financial Group Limited (the "Feeder").

### DIRECTORS

The Directors who held office during the year were:

Paddy Dear  
Rupert Dorey\*  
Reade Griffith  
David Jeffreys\*  
Byron Knief\*  
Greville Ward\*

\* Independent non-executive Directors

The remuneration for Directors is determined by resolution of the Voting Shareholder. Each of the Directors' annual fee is US\$ 75,000 in compensation for service on the Board of Directors of both the Fund and the Feeder and is paid by the Fund. Paddy Dear and Reade Griffith have waived their entitlement to a fee.

The Directors are entitled to be repaid by the Fund for all travel, hotel and other expenses reasonably incurred by them in the discharge of their duties. None of the Directors has a contract with the Fund or the Feeder providing for benefits upon termination of employment.

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# TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

## DIRECTORS' REPORT (continued) For the year ended 31 December 2013

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### DIVIDENDS

The Board of Directors has the authority to declare dividend payments, based upon the recommendation of the Investment Manager, subject to the approval of the voting shares of the Fund and adherence to applicable law including the satisfaction of a solvency test as stated under The Companies (Guernsey) Law, 2008. The Investment Manager's recommendation with respect to the declaration of dividends (and other capital distributions) may be informed by a variety of considerations, including (i) the expected sustainability of the Fund's cash generation capacity in the short and medium term, (ii) the current and anticipated performance of the Fund, (iii) the current and anticipated operating and economic environment and (iv) other potential uses of cash ranging from preservation of the Fund's investments and financial position to other investment opportunities. The Directors declared a dividend amounting to US\$ 0.135 per share for the Quarter Ended 31 December 2012, US\$ 0.135 per share for the Quarter Ended 31 March 2013, US\$ 0.14 for the Quarter Ended 30 June 2013 and US\$ 0.14 for the Quarter Ended 30 September 2013. The total dividend declared during the year ended 31 December 2013 amounted to US\$ 53.9 million or US\$ 0.55 per share (31 December 2012: US\$ 50.3 million or US\$ 0.44 per share). On 26 February, the Directors have declared a dividend US\$ 0.15 for the Quarter Ended 31 December 2013.

### STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

The Companies (Guernsey) Law, 2008, requires the Directors to prepare financial statements for each financial year. Under that law, they have elected to prepare the financial statements in conformity with U.S. generally accepted accounting principles ("U.S. GAAP") and applicable law.

The financial statements are required by law to give a true and fair view of the state of affairs of the Fund and of the profit or loss of the Fund for that period.

In preparing those financial statements, the Directors are required to:

- Select suitable accounting policies and apply them consistently;
- Make judgments and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Fund will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for the keeping of proper accounting records which disclose with reasonable accuracy at any time the financial position of the Fund and to enable them to ensure that the financial statements comply with The Companies (Guernsey) Law, 2008. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Fund and to prevent and detect fraud and other irregularities.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### DIRECTORS' REPORT (continued) For the year ended 31 December 2013

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#### STATEMENT OF DIRECTORS' RESPONSIBILITIES (continued)

The Directors confirm that they have complied with the above requirements in preparing the financial statements and that to the best of our knowledge and belief:

- This annual report includes a fair review of the development and performance of the businesses and the position of the Fund together with a description of the principal risks and uncertainties that the Fund faces; and
- The financial statements, prepared in conformity with U.S. GAAP give a true and fair view of the assets, liabilities, financial position and results of the Fund.

#### DISCLOSURE OF INFORMATION TO AUDITOR

So far as each of the Directors is aware, there is no relevant audit information of which the Fund's auditor is unaware, and each has taken all the steps he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Fund's auditor is aware of that information.

#### AUDITORS

KPMG has been appointed as independent auditors to perform a non-statutory audit of the Fund for certain regulatory purposes and they have expressed their willingness to continue in office.

Signed on behalf of the Board of Directors by:

Rupert Dorey, Director  
David Jeffreys, Director

Date: 26 February 2014

## **Independent Auditor's Report**

The Board of Directors  
Tetragon Financial Group Master Fund Limited

We have audited the accompanying consolidated financial statements of Tetragon Financial Group Master Fund Limited and its subsidiaries (the "Fund") which comprise the consolidated statements of assets and liabilities as of December 31, 2013 and 2012, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of the Fund and its subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG  
1 Harbourmaster Place  
IFSC  
Dublin 1  
Ireland  
February 26, 2014

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**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**  
**CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**  
**As at 31 December 2013**

	Note	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
<b>Assets</b>			
Investments, at fair value	2, 3	1,532,980	1,440,437
Management contracts	2, 4	36,544	43,395
Cash and cash equivalents	6	245,912	175,941
Amounts due from brokers	8	41,975	13,112
Derivative financial assets	7	15,159	7,620
Property, plant and equipment	2	276	30
Deferred tax asset	15	7,711	-
Prepaid income tax		562	-
Other receivables	9	26,588	15,620
<b>Total assets</b>		<u>1,907,707</u>	<u>1,696,155</u>
<b>Liabilities</b>			
Derivative financial liabilities	7	3,261	2,180
Other payables and accrued expenses	10	46,998	31,361
Income tax payable	15	600	2,094
Deferred tax liability	15	10,117	2,244
<b>Total liabilities</b>		<u>60,976</u>	<u>37,879</u>
<b>Net assets</b>		<u>1,846,731</u>	<u>1,658,276</u>
<b>Equity</b>			
Share capital	11	99	99
Share premium	12	922,447	924,189
Retained earnings	14	906,583	730,139
Capital contribution	19	17,602	3,849
		<u>1,846,731</u>	<u>1,658,276</u>
<b>Shares outstanding</b>		<b>Number</b>	<b>Number</b>
		<b>'000</b>	<b>'000</b>
Shares	11	98,938	98,805
<b>Net Asset Value per share</b>		US\$ 18.67	US\$ 16.78

The accompanying notes are an integral part of the consolidated financial statements.

Signed on behalf of the Board of Directors by:

Rupert Dorey, Director  
David Jeffreys, Director

26 February 2014

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

For the year ended 31 December 2013

	Note	Year ended 31 Dec 2013 US\$ '000	Year ended 31 Dec 2012 US\$ '000
Interest income	16	204,779	235,596
Fee income	17	74,336	36,704
Dividend income		80	-
Other income – cost recovery	2, 21	21,101	6,773
<b>Investment income</b>		<u>300,296</u>	<u>279,073</u>
Employee costs	21	(49,942)	(21,022)
Management fees	21	(25,124)	(23,564)
Share based employee compensation	19	(23,096)	(3,849)
Legal and professional fees	22	(9,148)	(12,369)
Audit fees		(374)	(376)
Other operating and administrative expenses		(25,339)	(8,791)
<b>Operating expenses</b>		<u>(133,023)</u>	<u>(69,971)</u>
<b>Net investment income</b>		<u>167,273</u>	<u>209,102</u>
<b>Net realized and unrealized gain from investments and foreign currency</b>			
Net realized gain / (loss) from:			
Investments		10,451	5,334
Derivative financial instruments		6,728	(15,820)
Foreign currency transactions		(5,259)	5,561
		<u>11,920</u>	<u>(4,925)</u>
Net increase in unrealized appreciation on:			
Investments		106,137	191,275
Derivative financial instruments		7,838	1,079
Translation of assets and liabilities in foreign currencies		8,856	2,359
		<u>122,831</u>	<u>194,713</u>
<b>Net realized and unrealized gain from investments and foreign currency</b>		<u>134,751</u>	<u>189,788</u>
Bargain purchase	19	-	54,774
<b>Net increase from operations before tax</b>		<u>302,024</u>	<u>453,664</u>
Income and deferred tax expense	15	(8,796)	(3,574)
<b>Net income</b>		<u>293,228</u>	<u>450,090</u>
<b>Net income attributable to:</b>			
Owners of the Company		293,228	448,399
Noncontrolling interest	11	-	1,691
		<u>293,228</u>	<u>450,090</u>

The accompanying notes are an integral part of the consolidated financial statements.

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
**For the year ended 31 December 2013**

	Note	Year ended 31 Dec 2013 US\$ '000	Year ended 31 Dec 2012 US\$ '000
From operations:			
Net investment income		167,273	209,102
Net realized gain / (loss) from investments and foreign currency		11,920	(4,925)
Net increase in unrealized appreciation on investments and translation of assets and liabilities in foreign currencies		122,831	194,713
Bargain purchase		-	54,774
Income and deferred tax expense	15	(8,796)	(3,574)
Net income after tax		<u>293,228</u>	<u>450,090</u>
Share based employee compensation		23,096	3,849
<b>Net increase in net assets resulting from operations</b>		<u>316,324</u>	<u>453,939</u>
Dividends paid to Feeder	13	(62,270)	(79,217)
Dividends paid to other shareholders	13	(53,922)	(50,296)
Distributions paid to noncontrolling interest	11	-	(1,845)
<b>Total distributions</b>		<u>(116,192)</u>	<u>(131,358)</u>
Issue of Shares	11	4,395	11,994
Purchase of Treasury Shares	11	(16,072)	(175,612)
<b>Decrease in net assets resulting from capital transactions</b>		<u>(11,677)</u>	<u>(163,618)</u>
<b>Total increase in net assets</b>		188,455	158,963
<b>Net assets at start of year</b>		1,658,276	1,499,313
<b>Net assets at end of year</b>		<u>1,846,731</u>	<u>1,658,276</u>

The accompanying notes are an integral part of the consolidated financial statements.

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**For the year ended 31 December 2013**

	Year ended 31 Dec 2013 US\$ '000	Year ended 31 Dec 2012 US\$ '000
<b>Operating activities</b>		
Net income	293,228	450,090
Adjustments for:		
Realized (gains) / losses on investments and derivatives	(17,179)	10,486
Cash received on investments in excess of interest income	254,350	229,619
Amortization on intangible assets	6,851	1,242
Depreciation on fixed assets	190	-
Bargain purchase	-	(54,774)
Share based employee compensation	23,096	3,849
Unrealized gains	(122,831)	(194,713)
Deferred tax	162	1,558
Operating cash flows before movements in working capital	<u>437,867</u>	<u>447,357</u>
Increase in receivables	(11,530)	(12,866)
Increase in payables	14,143	25,344
Cash flows from operations	<u>440,480</u>	<u>459,835</u>
Purchase of fixed assets	(436)	-
Proceeds from sale / prepayment / maturity of investments	116,739	89,626
Net proceeds from swap resets	5,528	-
Purchase of investments	(335,423)	(292,782)
<b>Net cash provided by operating activities</b>	<u>226,888</u>	<u>256,679</u>
<b>Financing activities</b>		
Amounts due from brokers	(28,863)	2,736
Proceeds from issue of Shares	4,395	11,994
Treasury Shares	(16,072)	(176,072)
Dividends paid to shareholders	(53,922)	(50,296)
Dividends paid to Feeder in lieu of incentive fee liability	(62,270)	(79,217)
Distributions to noncontrolling interest	-	(1,845)
<b>Net cash used in financing activities</b>	<u>(156,732)</u>	<u>(292,700)</u>
Net increase / (decrease) in cash and cash equivalents	70,156	(36,021)
<b>Cash and cash equivalents at beginning of year</b>	175,941	211,513
<b>Effect of exchange rate fluctuations on cash and cash equivalents</b>	(185)	449
<b>Cash and cash equivalents at end of year</b>	<u>245,912</u>	<u>175,941</u>

The accompanying notes are an integral part of the consolidated financial statements.

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**As at 31 December 2013**

<b>Security Description</b>	<b>Nominal '000</b>	<b>Cost US\$ '000</b>	<b>Fair Value US\$ '000</b>	<b>% of Net Assets</b>
<i>United States CLO Equity</i>				
<i>Cayman Islands</i>				
ABS and Structured Finance	18,400	17,572	-	-
Broadly Syndicated Senior Secured Loans	1,221,034	1,104,937	798,620	43.25%
CDOs Squared	17,250	16,640	-	-
Middle Market Senior Secured Loans	245,249	227,357	137,524	7.45%
	<u>1,501,933</u>	<u>1,366,506</u>	<u>936,144</u>	<u>50.70%</u>
<i>European CLO Equity</i>				
<i>Ireland</i>				
Broadly Syndicated Senior Secured Loans	127,400	155,917	101,771	5.51%
	<u>127,400</u>	<u>155,917</u>	<u>101,771</u>	<u>5.51%</u>
<i>Luxembourg</i>				
Broadly Syndicated Senior Secured Loans	71,100	84,317	59,916	3.24%
	<u>71,100</u>	<u>84,317</u>	<u>59,916</u>	<u>3.24%</u>
<i>Netherlands</i>				
Broadly Syndicated Senior Secured Loans	24,000	31,759	22,656	1.23%
	<u>24,000</u>	<u>31,759</u>	<u>22,656</u>	<u>1.23%</u>
<i>United States CLO Mezzanine</i>				
<i>Cayman Islands</i>				
Broadly Syndicated Senior Secured Loans	1,750	1,103	1,699	0.09%
	<u>1,750</u>	<u>1,103</u>	<u>1,699</u>	<u>0.09%</u>
<i>Loans</i>				
United States Broadly Syndicated Senior Secured Loans	33,816	33,482	34,017	1.84%
Global Unsecured Loan	10,000	10,000	11,069	0.60%
	<u>43,816</u>	<u>43,482</u>	<u>45,086</u>	<u>2.44%</u>
<i>Listed Stock</i>				
Germany – Equity Investments		45	49	0.00%
United Kingdom – Equity Investments		10,812	11,158	0.61%
		<u>10,857</u>	<u>11,207</u>	<u>0.61%</u>
<i>Unlisted Stock</i>				
Global Financial Real Estate Investment Manager		10,728	28,400	1.54%
		<u>10,728</u>	<u>28,400</u>	<u>1.54%</u>
<i>Investment Funds</i>				
United States – Real Estate		26,658	26,791	1.45%
Japan – Real Estate		12,296	10,820	0.59%
United Kingdom – Real Estate		22,148	23,159	1.25%
Global – Hedge Funds – Equities		55,000	56,554	3.06%
Polygon European Equity Opportunity Fund*		105,000	124,570	6.74%
Global – Hedge Funds – Credit and Convertible Bonds		80,000	84,207	4.57%
		<u>301,102</u>	<u>326,101</u>	<u>17.66%</u>
<b>Total Investments</b>		<u><b>2,005,771</b></u>	<u><b>1,532,980</b></u>	<u><b>83.02%</b></u>

\*The investment in the Polygon European Equity Opportunity Fund consists of 515,988 units in Class A, 355,786 units in Class B and 154,838 units in Class C as at 31 December 2013.

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**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS (continued)**  
**As at 31 December 2013**

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<b>Financial Derivative Instruments</b>	<b>Fair Value US\$ '000</b>	<b>% of Net Assets</b>
Interest Rate Swaptions	12,050	0.65%
Forward Foreign Currency Exchange Contracts	(3,183)	(0.17)%
Equity Total Return Swaps	3,031	0.16%
<b>Total Financial Derivative Instruments</b>	<u>11,898</u>	<u>0.64%</u>
Cash and Cash Equivalents	245,912	13.31%
Other Assets and Liabilities	55,941	3.03%
<b>Net Assets</b>	<u>1,846,731</u>	<u>100.00%</u>

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS (continued)**

**As at 31 December 2012**

Security Description	Nominal '000	Cost US\$ '000	Fair Value US\$ '000	% of Net Assets
<i>United States CLO Equity</i>				
<i>Cayman Islands</i>				
ABS and Structured Finance	18,400	17,572	-	-
Broadly Syndicated Senior Secured Loans	1,172,872	1,057,015	908,707	54.80%
CDOs Squared	17,250	16,640	-	-
Middle Market Senior Secured Loans	245,249	227,357	180,079	10.86%
	<u>1,453,771</u>	<u>1,318,584</u>	<u>1,088,786</u>	<u>65.66%</u>
<i>European CLO Equity</i>				
<i>Ireland</i>				
Broadly Syndicated Senior Secured Loans	127,400	155,917	75,069	4.53%
	<u>127,400</u>	<u>155,917</u>	<u>75,069</u>	<u>4.53%</u>
<i>Luxembourg</i>				
Broadly Syndicated Senior Secured Loans	65,100	80,652	32,233	1.94%
	<u>65,100</u>	<u>80,652</u>	<u>32,233</u>	<u>1.94%</u>
<i>Netherlands</i>				
Broadly Syndicated Senior Secured Loans	24,000	31,759	18,323	1.10%
	<u>24,000</u>	<u>31,759</u>	<u>18,323</u>	<u>1.10%</u>
<i>United States CLO Mezzanine</i>				
<i>Cayman Islands</i>				
Broadly Syndicated Senior Secured Loans	1,750	1,103	1,569	0.09%
	<u>1,750</u>	<u>1,103</u>	<u>1,569</u>	<u>0.09%</u>
<i>Loans</i>				
United States Broadly Syndicated Senior Secured Loans	114,253	112,231	114,057	6.88%
Global Unsecured Loan	9,500	9,500	10,091	0.61%
	<u>123,753</u>	<u>121,731</u>	<u>124,148</u>	<u>7.49%</u>
<i>Unlisted Stock</i>				
Global Financial Real Estate Manager		10,728	18,126	1.09%
		<u>10,728</u>	<u>18,126</u>	<u>1.09%</u>
<i>Investment Funds</i>				
United States – Real Estate		14,863	14,789	0.89%
Japan – Real Estate		3,847	3,821	0.23%
United Kingdom – Real Estate		7,036	7,074	0.43%
Global – Hedge Funds – Equities		45,000	46,429	2.80%
Global – Hedge Funds – Credit and Convertible Bonds		10,000	10,070	0.61%
		<u>80,746</u>	<u>82,183</u>	<u>4.96%</u>
<b>Total Investments</b>		<u><b>1,801,220</b></u>	<u><b>1,440,437</b></u>	<u><b>86.86%</b></u>
<b>Financial Derivative Instruments</b>				
			<b>Fair Value US\$ '000</b>	<b>% of Net Assets</b>
Interest Rate Swaptions			7,620	0.46%
Forward Foreign Currency Exchange Contracts			(2,180)	(0.13)%
<b>Total Financial Derivative Instruments</b>			<u>5,440</u>	<u>0.33%</u>
Cash and Cash Equivalents			175,941	10.61%
Other Assets and Liabilities			36,458	2.20%
<b>Net Assets</b>			<u><b>1,658,276</b></u>	<u><b>100.00%</b></u>

# TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

## FINANCIAL HIGHLIGHTS For the year ended 31 December 2013

The following represents selected per Share operating performance of the Fund, ratios to average net assets and total return information for the year ended 31 December 2013 and the year ended 31 December 2012.

	31 Dec 2013	31 Dec 2012
	US\$	US\$
<b>Per Share operating performance</b>		
Net Asset Value at start of year	16.78	12.93
Net investment income	1.71	1.85
Net realized and unrealized gain from investments, derivatives and foreign currencies	1.37	1.68
Bargain purchase	-	0.48
Share based employee compensation	0.24	0.03
Dividends paid to shareholders	(1.19)	(1.15)
Income and deferred tax expense and noncontrolling interest	(0.09)	(0.04)
Other capital transactions	(0.15)	1.00
Net Asset Value at the end of the year	18.67	16.78
<b>Pro Forma Fully Diluted NAV per Share</b>		
	<b>Shares '000</b>	<b>Shares '000</b>
Shares outstanding	98,938	98,805
Shares held in escrow	11,281	11,836
Pro Forma Fully Diluted Shares	110,219	110,641
Pro Forma Fully Diluted Net Asset Value per Share	US\$ 16.76	US\$ 14.99
Return (NAV change excluding dividends and other capital transactions)	19.25%	38.66%

### Ratios and supplemental data

Ratio to average net assets:		
Total operating expenses	(6.44%)	(3.90%)
Net investment income	9.80%	13.34%

An individual shareholder's per Share operating performance and ratios may vary from the above based on the timing of capital transactions.



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**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended 31 December 2013**

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**Note 1    General Information**

The Fund was registered in Guernsey on 23 June 2005 as a company limited by shares, with registered number 43322. All voting shares of the Fund are held by Polygon Credit Holdings II Limited. The Fund continues to be registered and domiciled in Guernsey.

The Fund owns a number of operating business subsidiaries, including those resulting from the acquisition of TFG Asset Management L.P. (formerly known as Polygon Management L.P.) and certain of its affiliates, including its asset management businesses (the "Acquisition"). The Fund consolidates in these financial statements, the income and expense and assets and liabilities of entities where appropriate, and in accordance with the accounting policy on consolidation detailed in Note 2.

The registered office of the Fund is 1st Floor Dorey Court, Admiral Park, St. Peter Port, Guernsey, Channel Islands GY1 6HJ.

**Note 2    Significant Accounting Policies**

**Basis of Presentation**

The consolidated financial statements give a true and fair view, are prepared in conformity with U.S. GAAP and comply with The Companies (Guernsey) Law, 2008.

For financial statement reporting purposes, the Fund is an investment company and follows Financial Services – Investment Companies (ASC 946).

Except for new standards adopted, the accounting policies have been consistently applied by the Fund during the year ended 31 December 2013 and are consistent with those used in the previous year.

The consolidated financial statements are presented in United States Dollars rounded to the nearest thousand.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes, including the valuation of investments. The Fund's management believes that the estimates utilized in preparing the consolidated financial statements are reasonable and prudent, however actual results could differ materially from these estimates.

**Foreign Currency Translation**

Transactions in foreign currencies are translated at the foreign currency exchange rate ruling at the date of the transaction. All assets and liabilities denominated in foreign currencies are translated to U.S. Dollars at the foreign currency closing exchange rate ruling at the reporting date. Foreign currency exchange differences arising on translation and realized gains and losses on disposals or settlements of monetary assets and liabilities are recognized in the Consolidated Statements of Operations.

Foreign currency exchange differences relating to derivative financial instruments are included in foreign currency transactions and translation of assets and liabilities in foreign currencies in the Consolidated Statements of Operations. All other foreign currency exchange differences relating to monetary items, including cash and cash equivalents and investments, are included in the foreign currency transactions and translation of assets and liabilities in foreign currencies in the Consolidated Statements of Operations.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 2 Significant Accounting Policies (continued)

##### Investment Transactions and Investment Income

Investment transactions are recorded on a trade date basis (the trade date is the date that an entity commits to purchase or sell an asset). Realized gains and losses from CLO equity and mezzanine securities, leveraged loans, forwards, swaptions, investment funds, swaps, contracts for difference, listed stock and unlisted stock are calculated on the identified historical cost basis. Interest income is recognized on an effective interest rate basis.

##### Financial Instruments

*Investments in CLO equity tranche investments ("CLO equity"), at fair value*

In the absence of an active market for the equity tranche investments in securitization vehicles, a mark to model approach has been adopted to determine their valuation. A third party valuation model that is used by the Investment Manager and the Administrator has been selected for this purpose. The model contains characteristics of the securitization vehicle structure, including current assets and liabilities and inception to date performance, based upon information derived by a specialist firm, from data sources such as the trustee reports. Key model inputs include asset spreads, expected defaults and expected recovery rates for the relevant category of underlying collateral held in the securitization vehicle. These inputs are derived by reference to a variety of market sources, which are used by both the Investment Manager and the Administrator. The model is used to project performance ("Expected IRR") for each investment, based on performance to date and expected future cash flows as well as to calculate fair value. As cash is received from the securitization vehicle, only the Expected IRR is recognized as income and any difference is treated as an adjustment of principal.

The fair value calculations for the equity tranches are sensitive to the key model inputs, including amongst other things, defaults and recovery rates. The default rate, recovery rate and other assumptions are determined by reference to a variety of observable market sources and applied according to the quality and asset class mix of the underlying collateral.

The model assumptions are reviewed on a regular basis and adjusted as appropriate to factor in historic, current and potential market developments. A different set of forward looking assumptions is applied according to whether the security is characterized as being U.S. or European.

The Fund recognizes interest income and any impairment pursuant to "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets" (ASC 325). ASC 325 sets forth rules for recognizing interest income and determining when an investment is impaired.

In accordance with ASC 325, the excess of the estimated future cash flows over the initial investment is the accretable yield which is recognized as interest income over the life of the investment using the effective yield method. Cash distributions received from investments under ASC 325 may not necessarily equal the income earned during any given year or period. The amortized cost of each investment is equal to the initial investment plus the yield accrued to date less all cash received to date less any write downs for impairment.

Investments are evaluated for impairment as of each month end or more frequently if the Fund becomes aware of any material information that would lead it to believe an investment may be impaired. Unrealized gains and losses occur when actual cash receipts differ from the amounts initially estimated, discount rates and / or assumptions included in the fair valuation models (such as estimated default rates, prepayment or recovery rates) have changed. Any investment with unrealized loss is tested for permanent impairment as required by ASC 325.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 2 Significant Accounting Policies (continued)

##### Financial Instruments (continued)

###### *Investments in leveraged loans, at fair value*

To the extent that the Fund's leveraged loans are exchange traded and are priced or have sufficient bid price indications from normal course trading at or around the valuation date (financial reporting date), such bid pricing will determine fair value. Pricing service marks from third party pricing services may be used as an indication of fair value, depending on the volume and reliability of the marks, sufficient and reasonable correlation of bid and ask quotes, and, most importantly, the level of actual trading activity.

###### *Investments in CLO mezzanine tranche investments, at fair value*

Investments in CLO mezzanine tranches are carried at fair value using the latest broker indicative bid prices. As the mezzanine tranches are marked-to-market, changes in the fair value are recognized immediately in the Consolidated Statements of Operations.

###### *Investments in securities, listed stock, unlisted common stock and unsecured loans, at fair value*

Investments in listed stock, unlisted common stock and unsecured loans are carried at fair value. Where applicable their cost price, the price at which any recent transaction in the security may have been effected and any other relevant factors may be considered, as well as valuation techniques which may be used by market participants.

###### *Investments in unlisted investment funds, at fair value*

Investments in unlisted investment funds are valued utilizing the net asset valuations provided by the managers of the underlying funds and / or their administrators. This approach is known as the "practical expedient" and has been applied in accordance with the Accounting Standards Update No. 2009-12 ("ASU 2009-12").

###### *Forward currency contracts, at fair value*

Forward currency contracts are recognized at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of fair value of a forward contract at initial recognition is the transaction price. Subsequent changes in the fair value of any forward contract are recognized immediately in the Consolidated Statements of Operations.

###### *Interest rate swaptions, at fair value*

This instrument combines the features of two other financial instruments, namely an option and an interest rate swap. A swaption involves writing / purchasing options to enter into a swap.

When the Fund purchases a swaption, a premium is paid by the Fund and the swaption is initially recognized at the amount of the premium. The swaption is subsequently marked-to-market to reflect the fair value of the swaption purchased, which is reported as an asset on the Consolidated Statements of Assets and Liabilities, and changes in the fair value are recognized immediately in the Consolidated Statements of Operations.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### **Note 2 Significant Accounting Policies (continued)**

##### **Financial Instruments (continued)**

###### *Swaps and Contracts for difference*

The Fund enters into swaps and contracts for difference (“CFDs”) arrangements with financial institutions. Swaps and CFDs are typically traded on the OTC market. The arrangement generally involves an agreement by the Fund and a counterparty to exchange the difference between the opening and closing price of the position underlying the contract, which are generally on equity positions.

The fair value of the swap or CFD is derived by taking the difference between the quoted price of the underlying security and the contract price. Realized and unrealized gains and losses are included in the Consolidated Statements of Operations.

##### **Property, Plant and Equipment**

Fixed assets (including property, plant and equipment) are stated at cost and depreciated on a straight-line basis over their estimated useful lives.

##### **Cash and Cash Equivalents**

Cash comprises current deposits with banks. Cash equivalents, short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

##### **Management Contracts**

Management contracts providing investment management services to investment funds, accounts and other vehicles are amortized over their useful lives. Management contracts are stated at cost less accumulated amortization and impairment. The Fund reviews purchased intangible assets for impairment where there are events or changes in circumstance that indicate the carrying value of an asset may not be recoverable.

Amortization is recognized through profit or loss in the Consolidated Statements of Operations on a straight-line basis over the useful life of the agreements. The estimated useful life for the purposes of amortizing management contracts ranges from three to ten years.

##### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Fund and its subsidiaries (collectively, the “Group”). All significant intercompany balances and transactions have been eliminated on consolidation.

The Fund consolidates all entities where it has an economic interest in excess of 50% and is deemed to have control over the significant operational and financial decisions. Where the Fund owns an interest which is less than 50% but more than 20%, consideration is made as to the level of control exercised. The Fund owns 23% of GreenOak, a real estate investment manager and certain of its affiliates. It has determined that it does not exhibit significant control over GreenOak and is therefore carrying this investment at fair value.

The Fund is the primary beneficiary of some securities which are considered variable interest entities (“VIE”). As the Fund is accounting for its investments at fair value in accordance with the accounting guidance in the AICPA Audit and Accounting Guide: Investment Companies and has determined that it does not have control over the significant operational and financial decisions of these securities, consolidation of these entities is not required. At 31 December 2013, the fair value of these VIEs is approximately US\$ 1,446.6 million (31 December 2012: US\$ 1,296.6 million).

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### **Note 2 Significant Accounting Policies (continued)**

##### **Principles of Consolidation (continued)**

These are non-recourse securities with no contingent liabilities where the Fund's maximum loss exposure is capped at the current carrying value.

##### **Business Combinations**

Business combinations are accounted for using the acquisition method as at the acquisition date – i.e. when control is transferred to the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that are currently exercisable.

The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When the excess is negative, a bargain purchase gain is recognized immediately in the Consolidated Statements of Operations.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

##### **Share Based Employee Compensation**

Share-based compensation expense for all equity settled share-based payment awards granted is determined based on the grant-date fair value. The Fund recognizes these compensation costs net of an estimated forfeiture rate, and recognizes compensation cost only for those shares expected to meet the service and performance vesting conditions, on a straightline basis over the requisite service period of the award. These compensation costs are determined at the aggregate grant level for service-based awards and at the individual vesting tranche level for awards with performance conditions.

The Feeder issues the shares to the employees or providers of employment like services whereas the Fund receives the related services, and consequently the share based payments expense is recognized as a capital contribution. When the shares are actually issued the fair value of the shares, as determined at the time of the award, is debited against capital contribution. Any associated stock dividends accrued on the original award are debited against retained earnings and credited to share capital and share premium using the value determined by the stock reference price at the date of each applicable dividend.

##### **Fee Income**

Fee income from management contracts is usually derived from either a base management fee, which is typically based on assets under management, or an incentive or performance fee which is linked to the performance of the applicable investment fund, account or vehicle. Base management fees are recognized on an accruals basis. Incentive or performance fees are recognized only when they have crystalized, which is usually on an annual or otherwise defined basis.

##### **Dividend Income**

Dividend income is recorded on the ex-dividend date, or when the information becomes available to the Fund.

##### **Other Income**

Where investment management, operating, infrastructure and administrative services are contractually provided to external entities outside of the consolidated Group, these services, along with any associated direct costs are invoiced and recorded as other income. This income is recognized on an accruals basis.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### **Note 2 Significant Accounting Policies (continued)**

##### **Expenses**

Expenses are recognized in the Consolidated Statements of Operations on an accruals basis.

##### **Taxation**

###### *Income taxes, Fund*

The Fund is exempt from Guernsey income tax under the Income Tax (Exempt Bodies) (Guernsey) Ordinance 1989 and is charged GBP 600 per annum. The Fund has consolidated U.S. and UK operating businesses which are subject to federal and local taxes as applicable.

###### *Income taxes, Corporate Entities*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are recognized for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that is no longer probable that the related tax benefit will be realized.

In accordance with ASC Subtopic 740-10 – Income Taxes – Overall, the Fund recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. There were no uncertain tax positions recognized at 31 December 2013.

##### **Dividend Expense**

Dividend expense from shares are recognized in the Consolidated Statements of Changes in Net Assets.

#### **Note 3 ASC 820, Fair Value Measurements**

The Fund adopted the provisions of “Fair Value Measurements” (ASC 820). ASC 820 defines fair value as the price that the Fund would receive to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date.

ASC 820 also establishes a framework for measuring fair value and a three level hierarchy for fair value measurement based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability.

The three levels of the fair value hierarchy are described below:

- Level 1 - Quoted in active markets for identical investments.
- Level 2 - Prices determined using other significant observable inputs. These may include quoted prices for similar securities, interest rates, prepayments speeds, credit risk and others.
- Level 3 - Unobservable inputs. Unobservable inputs reflect assumptions market participants would be expected to use in pricing the asset or liability.

## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

#### Note 3 ASC 820, Fair Value Measurements (continued)

The following is a summary of investments by asset class and level as of 31 December 2013 in valuing the Fund's assets carried at fair value:

	Level 1 US\$ '000	Level 2 US\$ '000	Level 3 US\$ '000	Total Fair Value US\$ '000
CLO Equity Tranches	-	-	1,120,487	1,120,487
CLO Mezzanine	-	1,699	-	1,699
Broadly Syndicated Senior Secured Loans	-	34,017	-	34,017
Unsecured Loan	-	-	11,069	11,069
Unlisted Stock	-	-	28,400	28,400
Listed Stock	11,207	-	-	11,207
Collective Investment Schemes	-	265,331	60,770	326,101
Interest rate swaptions	-	12,050	-	12,050
Forward foreign exchange contracts	-	(3,183)	-	(3,183)
Equity total return swaps	-	3,031	-	3,031
	11,207	312,945	1,220,726	1,544,878

There were no transfers of the Fund's assets between Level 1 and 2 during the year ended 31 December 2013 or during the year ended 31 December 2012.

The following is a summary of investments by asset class and level as of 31 December 2012 in valuing the Fund's assets carried at fair value:

	Level 1 US\$ '000	Level 2 US\$ '000	Level 3 US\$ '000	Total Fair Value US\$ '000
CLO Equity Tranches	-	-	1,214,411	1,214,411
CLO Mezzanine	-	1,569	-	1,569
Broadly Syndicated Senior Secured Loans	-	114,057	-	114,057
Unsecured Loan	-	-	10,091	10,091
Unlisted Stock	-	-	18,126	18,126
Collective Investment Schemes	-	56,499	25,684	82,183
Interest rate swaptions	-	7,620	-	7,620
Forward foreign exchange contracts	-	(2,180)	-	(2,180)
	-	177,565	1,268,312	1,445,877

The following is a reconciliation of the Fund's assets in which significant unobservable inputs (Level 3) were used in determining fair value at 31 December 2013.

	CLO Equity Tranches US\$ '000	Unsecured Loan US\$ '000	Unlisted Stock US\$ '000	Collective Investment Scheme US\$ '000	Total US\$ '000
Balance at start of year	1,214,411	10,091	18,126	25,684	1,268,312
Purchases of investments	73,145	500	-	43,516	117,161
Proceeds from sale of investments	-	-	-	(11,461)	(11,461)
Realized gain / change in unrealized appreciation	87,281	478	10,274	3,031	101,064
Amortization	(254,350)	-	-	-	(254,350)
Balance at end of year	1,120,487	11,069	28,400	60,770	1,220,726

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended 31 December 2013**

**Note 3 ASC 820, Fair Value Measurements (continued)**

The following is a reconciliation of the Fund's assets in which significant unobservable inputs (Level 3) were used in determining fair value at 31 December 2012.

	<b>CLO Equity Tranches US\$ '000</b>	<b>Unsecured Loan US\$ '000</b>	<b>Unlisted Stock US\$ '000</b>	<b>Collective Investment Scheme US\$ '000</b>	<b>Total US\$ '000</b>
Balance at start of year	1,147,381	7,051	482	2,408	1,157,322
Purchases of investments	112,082	2,625	10,246	25,045	149,998
Proceeds from sale of investments	(198)	-	-	(2,293)	(2,491)
Realized gain / change in unrealized appreciation / (depreciation)	184,765	415	7,398	524	193,102
Amortization	(229,619)	-	-	-	(229,619)
Balance at end of year	<u>1,214,411</u>	<u>10,091</u>	<u>18,126</u>	<u>25,684</u>	<u>1,268,312</u>

*Quantitative information about Level 3 Fair Value Measurements*

<b>Investments in securities</b>	<b>Balance at 31 December 2013 US\$ '000</b>	<b>Valuation methodology</b>	<b>Unobservable inputs</b>	<b>Range</b>
CLO Equity Tranches	1,120,487	Market standard model	See investments in CLO equity tranche investments	(I)
Unsecured Loan	11,069	Market standard model	Cost of financing for loan counterparty	3-6%
Common Stock	28,400	Market standard model	Price / earnings ratios Valuation as % of assets under management	6.5x - 10.5x 3-5%
Collective Investment Scheme	60,770	Net asset value of underlying investment companies	Lock up period	N/A

<b>Investments in securities</b>	<b>Balance at 31 December 2012 US\$ '000</b>	<b>Valuation methodology</b>	<b>Unobservable inputs</b>	<b>Range</b>
CLO Equity Tranches	1,214,411	Market standard model	See investments in CLO equity tranche investments	(I)
Unsecured Loan	10,091	Market standard model	Cost of financing for loan counterparty	3-6%
Common Stock	18,126	Market standard model	Valuation as % of assets under management	2-5%
Collective Investment Scheme	25,684	Net asset value of underlying investment companies	Lock up period	N/A

The fair value of the level 3 investments are sensitive to the inputs used in the valuation process. The CLO equity valuations are sensitive to a number of different inputs to the third party model. For example, if the default rate assumption inputs were increased, assuming all other inputs were held constant, then the fair value would decrease. Equally, if the discount rates applied to projected cash flows were increased, and similarly all other inputs were held constant, then the fair value would also decrease.



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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 3 ASC 820, Fair Value Measurements (continued)

##### *Quantitative information about Level 3 Fair Value Measurements (continued)*

The unsecured loan is valued with reference to an implied yield or cost of financing for the counterparty. If the implied yield were increased then the fair value of the loan would be reduced.

The common stock investment referenced in the table above is a 23% stake in GreenOak. As the GreenOak business has developed certain market metrics such as multiples of earnings have become more relevant than others such as discounted cash flows. As at 31 December 2013 the primary market metric utilised were price / earnings multiples (as indicated in the table above). A range of market derived multiples were applied to projected profitability of GreenOak and a valuation was selected from the range of fair values calculated. Given the greater inherent uncertainty in an early stage business a fair value in the 75th percentile was selected (i.e. in the lower half of the range). If the multiples applied to the projected profitability were decreased then the fair value range would also be decreased.

The collective investment schemes are valued using the net asset value of the underlying investment companies using the approach known as the "practical expedient". This is in accordance with ASU 2009-12.

##### *(1) CLO equity tranche investments*

As disclosed in Note 2, a mark to model approach has been adopted to determine the valuation of the equity tranche CLO investments. As at 31 December 2013, some of the modeling assumptions used are disclosed below.

##### U.S. CLO equity tranche investments –

The modeling assumptions disclosed below are a weighted average (by U.S. Dollar amount) of the individual deal assumptions, aggregated by geography (i.e. U.S. and European). Each individual deal's assumptions may differ from this geographical average and vary across the portfolio.

	<b>31 December 2013</b>	<b>31 December 2012</b>
Constant Annual Default Rate ("CADR")	Approximately 2.2%, which is 1.0x the original Weighted Average Rating Factor ("WARF") derived base-case default rate for the life of the transaction.	Approximately 2.2%, which is 1.0x the original Weighted Average Rating Factor ("WARF") derived base-case default rate for 2013-14 before changing to 2.75% or 1.25x the original base-case for 2015-17 and returning to 1.0x the base case thereafter.
Recovery Rate	73%, which is 1.0x of the original base-case assumed weighted-average recovery rate, for the life of the transaction.	73%, which is 1.0x of the original base-case assumed weighted-average recovery rate, for the life of the transaction.
Prepayment Rate	20% p.a., the original base-case prepayment rate with a 0% prepayment rate on bonds throughout the life of the transaction.	20% p.a., the original base-case prepayment rate with a 0% prepayment rate on bonds throughout the life of the transaction.
Reinvestment Price and Spread	Assumed reinvestment price is par for the life of the transaction, with an effective spread over LIBOR of approximately 289 bps on broadly U.S. syndicated loans and 328 bps on middle market loans for the life of the transaction.	Assumed reinvestment price is par for the life of the transaction, with an effective spread over LIBOR of approximately 284 bps on broadly U.S. syndicated loans and 328 bps on middle market loans for the life of the transaction.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 3 ASC 820, Fair Value Measurements (continued)

European CLO equity tranche investments -

	<b>31 December 2013</b>	<b>31 December 2012</b>
Constant Annual Default Rate ("CADR")	Approximately 2.6%, which is 1.25x the original WARF derived base-case default rate for 2013-14, changing to 2.1% or 1.0x the original base-case thereafter.	Approximately 3.1%, which is 1.5x the original WARF derived base-case default rate for 2013-14, changing to 2.6% or 1.25x the original base-case for 2015-17, changing to the original base-case thereafter.
Recovery Rate	68%, which is 1.0x of the original base-case assumed weighted-average recovery rate, for the life of the transaction.	68%, which is 1.0x of the original base-case assumed weighted-average recovery rate, for the life of the transaction.
Prepayment Rate	20% p.a., the original base-case prepayment rate with a 0% prepayment rate on bonds throughout the life of the transaction.	20% p.a., the original base-case prepayment rate with a 0% prepayment rate on bonds throughout the life of the transaction.
Reinvestment Price and Spread	The assumed reinvestment price is par for the life of the transaction with an effective spread over LIBOR of approximately 272 bps.	The assumed reinvestment price is par for the life of the transaction with an effective spread over LIBOR of approximately 272 bps.

When determining the fair value of the equity tranches a discount rate is applied to the expected future cash flows derived from the third party valuation model. The discount rate applied to those future cash flows reflects the perceived level of risk that would be used by another market participant in determining fair value. In determining the discount rates to use an analysis of the observable risk premium data as well as the individual deal's structural strength and credit quality is undertaken.

As at 31 December 2013, for the pre-2010 vintage U.S. equity tranches, the Fund applies a 13.0% discount rate to the expected future cashflows (31 December 2012: 17.5% discount rate to those equity tranches determined to be relatively stronger in terms of structure and credit quality and 22.5% to remainder). The European equity tranches are all discounted at 17.0% (31 December 2012: 27.5%). For both U.S. and European deals the aforementioned discount rates represent a significant spread over observed yields on the applicable BB-rated CLO tranches for each geographical region at that date.

For the post-2010 vintage U.S. equity tranches the applicable discount rate is determined with reference to each deal's specific IRR, which, in the absence of other observable data points, is deemed to be the most appropriate indication of the current risk premium on these structures. At the year end, the discount rate applied to these deals ranged from 7.3% to 16.1% with a weighted average of 11.6% (31 December 2012: 9.7% to 15.1% with a weighted average of 12.4%). Such deals represented approximately 17.7% (31 December 2012: 14.3%) of the CLO equity portfolio by fair value.

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended 31 December 2013**

**Note 4 Management Contracts**

During 2012, the Fund acquired TFG Asset Management L.P. (formerly known as Polygon Management L.P.) and certain of its affiliates. Of the assets that were purchased, intangible assets consisting of management contracts for hedge funds and private equity funds were identified. These are tested for impairment on a regular basis and are amortized over an estimated useful life as detailed below.

<b>31 December 2013</b>					
	<b>Weighted average amortization period</b>	<b>Gross carrying amount US\$ '000</b>	<b>Weighted average outstanding amortization period</b>	<b>Accumulated amortization US\$ '000</b>	<b>Net carrying amount US\$ '000</b>
Amortizing intangible assets:					
Management contracts – hedge funds	10 years	34,282	8 years 10 months	4,000	30,282
Management contracts – private equity	3 years	10,246	1 year 10 months	3,984	6,262
CLO Management contracts	3 years	303	-	303	-
<b>Total</b>		<b>44,831</b>		<b>8,287</b>	<b>36,544</b>

<b>31 December 2012</b>					
	<b>Weighted average amortization period</b>	<b>Gross carrying amount US\$ '000</b>	<b>Weighted average outstanding amortization period</b>	<b>Accumulated amortization US\$ '000</b>	<b>Net carrying amount US\$ '000</b>
Amortizing intangible assets:					
Management contracts – hedge funds	10 years	34,282	9 years 10 months	571	33,711
Management contracts – private equity	3 years	10,246	2 years 10 months	570	9,676
CLO Management contracts	3 years	303	1 month	295	8
<b>Total</b>		<b>44,831</b>		<b>1,436</b>	<b>43,395</b>

Aggregate amortization expense for amortizing intangible assets was US\$ 6.9 million for the year ended 31 December 2013 (31 December 2012: US\$ 1.2 million). Estimated amortization expense for the next nine years is US\$ 6.8 million in 2014, US\$ 6.3 million in 2015, US\$ 3.4 million in years 2016 to 2021 and US\$ 3.0 million in 2022.

**Note 5 GreenOak**

The Fund owns a 23% interest in GreenOak. It has determined that it does not have control over the significant operational and financial decisions of GreenOak and is carrying both the investment in GreenOak and working capital loan at fair value.

The following table outlines the movement in fair value of the GreenOak financial real estate manager:

	<b>31 Dec 2013 US\$ '000</b>	<b>31 Dec 2012 US\$ '000</b>
Opening fair value	18,126	482
Purchase	-	10,246
Change in unrealized appreciation	10,274	7,398
<b>Closing fair value</b>	<b>28,400</b>	<b>18,126</b>

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 5 GreenOak (continued)

The Fund has provided GreenOak with working capital of up to US\$ 10.0 million in the form of a seven year non-recourse loan facility. Under the terms of this facility, the first US\$ 5.0 million will earn an annual interest rate of 3% and the balance will earn an annual interest rate of 6%. As part of the Acquisition, the Fund increased its working capital commitment by an additional US\$ 0.5 million by assuming the acquiree's remaining unfunded commitment. This additional commitment earns an annual interest rate of 6% once funded.

The following table outlines the movement in the fair value of the unsecured working capital facility provided by the Fund to GreenOak.

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Opening fair value	10,091	7,051
Working capital contributed	500	2,625
Unrealized appreciation	478	415
Closing fair value	<u>11,069</u>	<u>10,091</u>

#### Note 6 Cash and Cash Equivalents

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Cash and current deposits with banks	237,899	164,895
Foreign currency cash with banks (cost: US\$ 7.9 million (31 December 2012: US\$ 10.8 million))	8,013	11,046
	<u>245,912</u>	<u>175,941</u>

Of this cash balance, approximately US\$ 4.5 million was held with respect to certain capital requirements in regulated entities (31 December 2012: US\$ 4.5 million).

#### Note 7 Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk

To the extent prices may be obtained on some or all of the Fund's assets, those prices may be extremely volatile, and will generally fluctuate due to a variety of factors that are inherently difficult to predict, including, but not limited to, changes in interest rates, prevailing credit spreads, general economic conditions, financial market conditions, domestic and international economic or political events, developments or trends in any particular industry, and the financial condition of the obligors of the Fund's assets.

The Fund's assets include securities or other financial instruments or obligations which are very thinly traded or for which no market exists or which are restricted as to their transferability under applicable securities laws. The valuation of the CLO equity tranche investments is determined using a third-party cash flow modeling tool.

The model contains certain assumption inputs that are reviewed and adjusted as appropriate to factor in how historic, current and potential market developments (examined through, for example, forward-looking observable data) might potentially impact the performance of these CLO equity investments.

Since this involves modeling, among other things, forward projections over multiple years, this is not an exercise in recalibrating future assumptions to the latest quarter's historical data.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 7 Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Subject to the foregoing, when determining the U.S. GAAP-compliant fair value of the CLO equity investments, the Fund seeks to derive a value at which market participants could transact in an orderly market and also seeks to benchmark the model inputs and resulting outputs to observable market data when available and appropriate. Although seeking to utilize, where possible, observable market data, for certain assumptions the Investment Manager may be required to make subjective judgements and forward-looking determinations, and its experience and knowledge is instrumental in the valuation process.

Further, because of overall size or concentration in particular markets of positions held by the Fund, the value at which its investments can be liquidated may differ, sometimes significantly, from the interim valuations arrived at.

The majority of the Fund's investments consist of interests in and / or economic exposures to limited recourse securities that are subordinated in right of payment and ranked junior to other securities that are secured by the same pool of assets. In the event of default by an issuer in relation to such investments holders of the issuer's more senior securities will be entitled to payments in priority to the Fund.

Some of the Fund's investments may also have structural features that divert payments of interest and / or principal to more senior classes secured by the same pool of assets when the delinquency or loss experience of the pool exceeds certain levels. This may lead to interruptions in the income stream that the Fund anticipates receiving from its investment portfolio. To the extent that actual losses on the underlying collateral exceed the level of assumed losses used to determine the fair value of the investment, the value of the investment may be reduced.

Some of the Fund's assets are held by a custodian and the Fund is exposed to the credit risk of this counterparty. The Fund has also entered into derivative transactions which results in exposure to counterparty credit risk. The counterparties to these derivative transactions are major financial institutions.

As part of the Fund's current investment strategy it may employ hedging strategies and leverage in seeking to provide attractive returns from the portfolio while managing risk. The hedging strategy may include the use of single name or index credit hedges when and where appropriate as well as foreign exchange rate hedges and interest rate swaptions. This is reviewed on an on-going basis in order to seek to address identified risks to the extent practicable and in a cost effective manner. As at 31 December 2013 and 31 December 2012 there were no credit hedges in place.

As at 31 December 2013, the Fund has one long interest rate swaption contract with an out-of-the-money strike and a notional of US\$ 500 million (31 December 2012: US\$ 600 million). The primary purpose of this position is to act as a hedge in a rising interest rate environment, particularly with reference to the CLO portfolio.

As at 31 December 2013, the Fund had several forward foreign exchange contracts in place with original maturities ranging from three months to approximately four years. The Fund typically agrees to sell foreign currency and buy USD in order to hedge long non-USD investment positions. The total open balance as the end of the year was net long US\$ 186.4 million, having executed 17 transactions during the year at an average notional of US\$ 34.8 million.

The Fund's investments in leveraged loans through equity tranche investments in securitization vehicles generate LIBOR plus returns and are sensitive to interest rate levels and volatility. Although these vehicles are structured to hedge interest rate risk through the use of matched funding, there may be some difference between the timing of LIBOR resets on the liabilities and assets, which could have a negative effect on the amount of funds distributed to equity tranche holders.

Furthermore, in the event of a significant rising interest rate environment and / or economic downturn, loan defaults may increase and result in credit losses that may be expected to affect the Fund's cash flow, fair value of its assets and operating results adversely. The Fund may utilize hedging instruments, such as interest rate swaptions, to try and mitigate interest rate tail risks.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### **Note 7 Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)**

The Fund did not have a significant concentration of credit risk exposure to leveraged loans at 31 December 2013 or 31 December 2012. No individual investment in leveraged loans exceeded 0.25% of the net assets at 31 December 2013 or 31 December 2012.

The Fund is exposed to credit risk through its investment in GreenOak investment funds and the working capital it has provided to GreenOak through a seven year non-recourse loan facility, maturing on 16 September 2017. Bankruptcy or insolvency of GreenOak may cause the Fund's rights with respect to the investment funds to be delayed or limited. The maximum exposure to GreenOak at 31 December 2013 and 31 December 2012 is disclosed on the Consolidated Condensed Schedule of Investments.

The Fund has made investments into certain collective investment schemes. These include real estate investment vehicles and hedge funds which have exposure to securities including equities, convertible bonds and derivatives. These underlying investments may be in securities or assets which are illiquid and / or in different geographies around the world. These investments may be subject to counterparty risk. Capital invested in to the investment vehicles may be subject to lock ups and gates, or subject to the realization of the underlying investments and assets. The Fund has also made investments into equities which are directly held. These investments are subject to market and liquidity risk.

The Fund enters into swaps and CFDs with financial institutions. The Fund utilizes these swap or CFD agreements as an efficient means of hedging or of obtaining exposure to certain underlying investments. The Fund is subject to the risk of the inability or refusal to perform with respect to such contracts on the part of counterparties trading with it, as well as risks relating to the creditworthiness of the swap counterparty, market risk, liquidity risk and operations risk. Through swaps or CFDs the Fund can in effect be exposed to increases or decreases in the value of an equity or index or to decreases or increases in the value of a related equity or index. Depending on how they are used, the agreements may increase or decrease the overall volatility of the portfolio and performance of the Fund. During the period from June to December 2013 the Fund had a weighted average notional exposure of US\$ 165.5 million through swaps referencing underlying individual equity positions. Prior to June 2013 the Fund did not have any open equity swap positions.

The Fund's investments that are denominated in currencies other than U.S. Dollar are subject to the risk that the value of such currency will decrease in relation to the U.S. Dollar. The Fund currently uses foreign exchange rate forwards to seek to hedge this currency risk in whole or in part, to the extent practicable and in a cost effective manner. As described above, the hedging strategy (including these currency hedges) is reviewed on an on-going basis. Details of the Fund's investment portfolio at the reporting date are disclosed in the Consolidated Condensed Schedule of Investments on pages 11 and 12.

The Fund is required to disclose the impact of offsetting assets and liabilities represented in the statements of assets liabilities to enable evaluation of the effect or potential effect of netting arrangements on its financial position for recognized assets and liabilities.

As of December 31 2013, the Fund holds financial instruments and derivative instruments that are eligible for offset in the statements of assets and liabilities and are subject to a master netting arrangement. The master netting arrangement allows the counterparty to net any collateral held on behalf of the Fund or liabilities or payment obligations of the counterparty against any liabilities or payment obligations of the Fund to the counterparty.

The following table provides disclosure regarding the potential effect of offsetting of recognized assets presented in the statement of assets and liabilities:

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
For the year ended 31 December 2013

**Note 7 Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)**

Description	31 December 2013					
	Gross Amount of Recognized Assets US\$ '000	Gross Amounts Offset in the Statements of Assets and Liabilities US\$ '000	Net Amounts Presented in the Statements of Assets and Liabilities US\$ '000	Financial instruments eligible for netting US\$ '000	Cash Collateral received/ Posted US\$ '000	Net Amount US\$ '000
<b>Assets</b>						
Derivatives	15,159	0	15,159	(16)	0	15,143
Total	15,159	0	15,159	(16)	0	15,143
<b>Liabilities</b>						
Derivatives	3,261	0	3,261	(16)	(3,183)	62
Total	3,261	0	3,261	(16)	(3,183)	62

Description	31 December 2012					
	Gross Amount of Recognized Assets US\$ '000	Gross Amounts Offset in the Statements of Assets and Liabilities US\$ '000	Net Amounts Presented in the Statements of Assets and Liabilities US\$ '000	Financial instruments eligible for netting US\$ '000	Cash Collateral received/ Posted US\$ '000	Net Amount US\$ '000
<b>Assets</b>						
Derivatives	7,620	0	7,620	0	0	7,620
Total	7,620	0	7,620	0	0	7,620
<b>Liabilities</b>						
Derivatives	2,180	0	2,180	0	(2,180)	-
Total	2,180	0	2,180	0	(2,180)	-

**Note 8 Amounts Due From Brokers**

The amounts due from brokers is cash pledged as collateral on the forward contracts and equity swaps. At 31 December 2013 the collateral cash balance with UBS AG was US\$ 29.0 million (31 December 2012: US\$ 13.1 million) and Bank of America Merrill Lynch was US\$ 13.0 million (31 December 2012: US\$ Nil).

**Note 9 Other Receivables**

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Accrued fee income	21,355	9,645
Rent deposits on properties	1,754	1,708
Amounts receivable on sale of investments	-	510
Other receivables	3,479	3,757
	<u>26,588</u>	<u>15,620</u>

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended 31 December 2013**

**Note 10 Other Payables and Accrued Expenses**

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Employee costs	33,866	22,234
Amounts owing to former Polygon partners (see Note 21)	6,907	6,982
Other operating and administrative expenses	6,225	2,145
	46,998	31,361

**Note 11 Share Capital**

**Authorized**

The Fund has an authorized share capital of US\$ 1.0 million divided into 10 voting shares, having a par value of US\$ 0.001 each and 999,999,990 non-voting shares (which are the "Shares" referred to herein), having a par value of US\$ 0.001 each.

**Voting Shares**

All of the Fund's voting shares are issued at par and are beneficially owned by the Voting Shareholder, a non-U.S. affiliate of the Investment Manager. The voting shares will be the only shares entitled to vote for the election of Directors and on all other matters put to a vote of shareholders, subject to the limited rights of the Shares described below. The voting shares are not entitled to receive dividends.

**Non-Voting Shares**

The Shares carry a right to any dividends or other distributions declared by the Fund. The Shares are not entitled to vote on any matter other than limited voting rights in respect of variation of their own class rights.

**Dividend Rights**

Dividends may be paid to the holders of Shares at the sole and absolute discretion of the Directors. The voting shares carry no rights to dividends.

**Share Transactions**

	<b>Voting Shares</b>	<b>Shares</b>	<b>Shares</b>
	<b>No.</b>	<b>No. '000</b>	<b>US\$ '000</b>
Shares in issue at 31 December 2011	10	115,968	116
Issued in lieu of stock dividend	-	1,530	2
Treasury Shares purchased during the year	-	(18,693)	(19)
Shares in issue at 31 December 2012	10	98,805	99
Issued in lieu of stock dividend	-	413	-
Issued through release of tranche of Escrow Shares	-	1,165	1
Treasury Shares purchased during the year	-	(1,445)	(1)
Shares in issue at 31 December 2013	10	98,938	99

**Treasury Shares**

The Fund owns a subsidiary, TFG Holdings I, to which it may transfer, and has transferred, Shares previously held in a Treasury Account. Where this occurs the status of the Shares is unchanged from an accounting perspective and they are not included in the Shares outstanding on the Consolidated Statements of Assets and Liabilities.



# TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

### Note 11 Share Capital (continued)

#### Treasury Shares (continued)

On 30 November 2007, the Feeder announced the implementation of a share repurchase program of their outstanding Shares. This was renewed on several occasions, most recently on 14 January 2013 running until 30 April 2013 when it expired. As at 31 December 2013 there was no share repurchase program in place.

When the program was in operation, the Fund undertook to repurchase an identical number of its own Shares from the Feeder as and when it made these repurchases in the open market.

The Fund matched the price per Share paid by the Feeder. The Shares are held in a Treasury Account or in a subsidiary allowing them to potentially be resold back to the Feeder if it resells its own shares back into the market at a later date. Whilst they are held by the Fund (whether directly or via a subsidiary), the Shares are neither eligible to receive dividends nor are they included in the Shares outstanding on the Statements of Assets and Liabilities.

As at 31 December 2013, 16.6 million Shares are held in TFG Holdings I (31 December 2012: 16.6 million) and 7.9 million Shares in the Treasury Account (31 December 2012: 6.5 million) with an aggregate attributed cost of US\$ 210.1 million (31 December 2012: US\$ 194.0 million).

#### Treasury Share Transactions

	<b>Treasury Shares</b>	<b>Shares held in subsidiary</b>
	<b>Shares</b>	<b>Shares</b>
	<b>No. '000</b>	<b>No. '000</b>
Shares brought forward at 31 December 2011	7,577	8,523
Treasury Shares purchased during the year	18,693	-
Shares transferred to subsidiary	(15,385)	15,385
Shares transferred to Feeder in connection with the Acquisition	(4,382)	(7,304)
Treasury Shares at 31 December 2012	6,503	16,604
Treasury Shares purchased during the year	1,445	-
Treasury Shares at 31 December 2013	7,948	16,604

#### Noncontrolling Interest

The Fund adopted "Noncontrolling Interests in Consolidated Financial Statements" (ASC 810) which requires noncontrolling interests to be classified in the Consolidated Statements of Operations as part of consolidated net earnings and to include the accumulated amount of noncontrolling interests in the Consolidated Statements of Assets and Liabilities as part of shareowners' equity. Any distributions to the noncontrolling interest are recorded in the Consolidated Statements of Cash Flows.

The table below shows a reconciliation in the movement in noncontrolling interest for the years ending 31 December 2013 and 31 December 2012.

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Balance at start of year	-	154
Attributed to noncontrolling interest	-	1,691
Distributions paid to noncontrolling interest	-	(1,845)
Balance at end of year	-	-

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended 31 December 2013**

**Note 12 Share Premium**

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Balance at start of year	924,189	1,087,790
Premium arising from issuance of Shares	14,329	11,992
Discount arising from purchase of Shares	(16,071)	(175,593)
Balance at end of year	922,447	924,189

**Note 13 Dividends**

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Quarter ended 31 December 2011 of US\$ 0.105 per share	-	12,080
Quarter ended 31 March 2012 of US\$ 0.105 per share	-	12,073
Quarter ended 30 June 2012 of US\$ 0.115 per share	-	13,079
Quarter ended 30 September 2012 of US\$ 0.115 per share	-	13,064
Quarter ended 31 December 2012 of US\$ 0.135 per share	13,266	-
Quarter ended 31 March 2013 of US\$ 0.135 per share	13,159	-
Quarter ended 30 June 2013 of US\$ 0.14 per share	13,661	-
Quarter ended 30 September 2013 of US\$ 0.14 per share	13,836	-
	53,922	50,296

The fourth quarter dividend of US\$ 0.15 per share was approved by the Directors on 26 February 2014 and has not been included as a liability in these consolidated financial statements.

The Fund also pays a dividend to the Feeder that is sufficient to pay their incentive fee liability which in the year ended 31 December 2013 was US\$ 62.3 million (31 December 2012: US\$ 79.2 million).

**Note 14 Retained Earnings**

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Balance at start of year	730,139	411,253
Net income resulting from operations for the year	293,228	448,399
Dividends paid to shareholders	(53,922)	(50,296)
Stock dividends on Shares released from Escrow	(592)	-
Dividends paid to Feeder	(62,270)	(79,217)
Balance at end of year	906,583	730,139

**Note 15 Income and Deferred Tax Expense**

Income tax for the years ended 31 December 2013 and 31 December 2012 consists of:

	Current US\$ '000	Deferred US\$ '000	Total US\$ '000
Year ended 31 December 2013:			
U.S. Federal and local	8,634	(6,602)	2,032
UK	-	6,764	6,764
	8,634	162	8,796

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended 31 December 2013**

**Note 15 Income and Deferred Tax Expense (continued)**

	<b>Current</b>	<b>Deferred</b>	<b>Total</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Year ended 31 December 2012:			
U.S. federal	1,279	1,558	2,837
U.S. State and local	737	-	737
	<u>2,016</u>	<u>1,558</u>	<u>3,574</u>

US\$ 0.6 million of current tax was payable at the end of the year (31 December 2012: US\$ 2.1 million) with US\$ 0.6 million receivable (31 December 2012: US\$ Nil).

**Tax Rate Reconciliation**

Income tax expense was US\$ 8.8 million for the year ended 31 December 2013, and differed from the amounts computed by applying the U.S. federal income tax of 34% to pretax increase in the net assets as a result of the following:

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Net increase in operations before tax	302,024	453,664
Computed "expected" tax expense at 34%	102,688	154,245
<i>Deduction in income taxes resulting from:</i>		
Income not subject to U.S. tax	(96,931)	(151,407)
State and local income taxes	3,039	737
Other exemptions net	-	(1)
Total income and deferred tax expense	<u>8,796</u>	<u>3,574</u>

**Deferred Tax**

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Deferred tax assets		
Employee compensation payments	7,115	-
Loss carried forward	596	-
Total deferred tax assets	<u>7,711</u>	<u>-</u>
Deferred tax liabilities		
Undistributed earnings	622	2,244
Amortisation of intangible assets	9,495	-
Total deferred tax liabilities	<u>10,117</u>	<u>2,244</u>
Net deferred tax (liabilities)	<u>(2,406)</u>	<u>(2,244)</u>

Deferred tax assets include US\$ 7.1 million relating to amounts accrued for employee compensation in 2013 which will only be an allowable expense in 2014 for tax purposes, and US\$ 0.6 million relating to losses carried forward.

US\$ 9.5 million is being recognized as a deferred tax liability due to the amortisation on management contracts being a disallowable expense for tax purposes. This will be released over time as the management contracts are amortized. US\$ 0.6 million has also been recognized as a liability with respect to applicable undistributed earnings at a withholding rate of 5%.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 16 Interest Income

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Debt securities – CLO equity tranches and mezzanine tranches	201,514	229,286
Debt securities – Leveraged loans	2,429	5,633
Cash and other	358	264
Debt securities – Unsecured loans	478	413
	<u>204,779</u>	<u>235,596</u>

#### Note 17 Fee Income

	31 Dec 2013 US\$ '000	31 Dec 2012 US\$ '000
Management fees		
CLO	41,464	28,299
Hedge Funds	18,729	3,677
Private equity	1,357	2,639
Performance fees	12,786	2,089
	<u>74,336</u>	<u>36,704</u>

CLO management fee income generally comprises senior and subordinated fees and in aggregate these fees currently range from 25 bps to 50 bps per annum of collateral under management. In addition to fee income earned on CLOs directly managed it also includes fee income derived from a number of one-off and long-term fee sharing arrangements with third parties. In 2013 these third party fees generated US\$ 20.3 million (31 December 2012: US\$ 8.2 million).

Hedge fund management fees charged to external investors are typically 150 bps of net assets under management and depending upon the applicable fund and share class certain other expenses may also be recovered. Management fees paid in connection with the private equity style vehicle are either 200 bps of net assets under management or a fixed declining management fee depending on the applicable class.

Performance or incentive fees may be earned on a hedge fund vehicles contingent upon the terms of each vehicle and the share class where applicable. They may also be earned through management of CLO vehicles once the vehicle has generated a specified return for the equity or subordinated tranche. During the year, such fees totaling US\$ 12.8 million were earned (31 December 2012: US\$ 2.1 million).

Where the Fund invests in Polygon hedge fund or other investment vehicles, it is able to invest at a preferred level of fees. The fees received by such affiliated managers from the Fund's investment are included and recognized in fee income reported in the Fund's consolidated statements of operations. During the year, these fee income amounts were US\$ 0.6 million of management fees (31 December 2012: US\$ nil) and US\$ 0.9 million of performance fees (2012: US\$ nil). The Fund also invests on preferred fee terms with its other affiliated asset managers (i.e. LCM and GreenOak).

#### Note 18 Segmental Reporting

##### Description of Segments

In pursuit of the Fund's investment objective to generate distributable income and capital appreciation, it currently maintains two key business segments: an investment portfolio and an asset-management platform.

Both business segments cover a broad range of assets including bank loans, real estate, equities, credit and convertible bonds. The Fund currently invests primarily through long-term funding vehicles such as collateralized loan obligations.

**TETRAGON FINANCIAL GROUP MASTER FUND LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended 31 December 2013**

**Note 18 Segmental Reporting (continued)**

**Segment Data**

The asset management platform segment currently contains three investment manager businesses: Polygon, LCM and GreenOak. These three businesses provide investment management and other services to a number of investment funds, accounts, vehicles and other managers, including CLOs, hedge funds, real estate funds and a private equity vehicle. The Polygon asset management business also has agreements to provide certain infrastructure and other services to the Investment Manager and certain affiliates as detailed in note 21. Some fee income is earned through certain short and long-term fee agreements with third parties.

The results for the year ended 31 December 2013 are presented to show the split of revenues, income and net income across the two business segments. The asset management segment incorporates the consolidated results of Polygon and LCM. The Fund owns 23% of GreenOak and is carrying this as an investment at fair value; consequently any unrealized gain or loss is being reflected through the investment portfolio segment.

In arriving at the net income split between the two segments a number of assumptions have been made as to how the expenses of the consolidated business should be split. Expenses of the asset management segment include amortization of management contracts.

<b>Year ended 31 December 2013:</b>	<b>Investment portfolio US\$ '000</b>	<b>Asset-management platform US\$ '000</b>	<b>Total US\$ '000</b>
Interest income	204,477	302	204,779
Fee income	-	74,336	74,336
Dividend income	80	-	80
Other income – cost recovery	-	21,101	21,101
Total segment income	<u>204,557</u>	<u>95,739</u>	<u>300,296</u>
Management fees and operating expenses	(93,066)	(81,756)	(174,822)
Realized and unrealized gains	124,477	6,206	130,683
Total segment net income before taxes	<u>235,968</u>	<u>20,189</u>	<u>256,157</u>

<b>Year ended 31 December 2012:</b>	<b>Investment portfolio US\$ '000</b>	<b>Asset-management platform US\$ '000</b>	<b>Total US\$ '000</b>
Interest income	235,395	201	235,596
Fee income	-	36,704	36,704
Other income – cost recovery	-	6,773	6,773
Total segment income	<u>235,395</u>	<u>43,678</u>	<u>279,073</u>
Management fees and operating expenses	(121,943)	(30,398)	(152,341)
Realized and unrealized gains	182,390	2,376	184,766
Total segment net income before taxes	<u>295,842</u>	<u>15,656</u>	<u>311,498</u>

The prior year has been restated in a comparable format to the current year. This includes recognizing net unrealized gains on the investment in GreenOak in the Asset Management segment rather than the Investment Portfolio segment and certain expenses of the Feeder in both segments. A full reconciliation to U.S. GAAP net income is included below.

# TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

### Note 18 Segmental Reporting (continued)

#### Segment Data (continued)

Reconciliation of segment net income before taxes to net income per the Consolidated Statements of Operations.

	<b>Year ended 31 Dec 2013</b>	<b>Year ended 31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Total segment net income before noncontrolling interest and taxes	256,157	311,498
Bargain purchase	-	54,774
Income and deferred tax expense	(8,796)	(3,574)
Share based employee compensation	(23,096)	(3,849)
Add back certain expenses of the Feeder	68,963	91,241
<b>Net income</b>	<b>293,228</b>	<b>450,090</b>

#### Geographical Split of Revenues

The Fund does not formally monitor, for the purposes of controlling the business, the geographical split of income for either of the two segments. A geographical split of the fee income generated by the asset management can generally, however, be derived, by considering where the primary investment management service was provided. This is a subjective exercise and involves, in some cases, making determinations that the Fund has only made purely for the purpose of completing this table.

	<b>UK</b>	<b>U.S.</b>	<b>Total</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Asset Management Segment			
Fee income	36,158	59,279	95,437

The 2012 comparison for the short period after the Acquisition has not been included.

A geographical split of income for the Investment Portfolio has not been provided, although certain geographical information has been provided in the Consolidated Condensed Schedule of Investments on pages 11 and 12 and a geographic split of the investment portfolio is reported on a monthly basis on the Feeder's website.

#### Net Assets Split by Business Segment

The Fund also does not formally monitor or report internally on net assets split by business segment. For the purposes of compiling a split for this segmental note the Asset Management segment net assets are deemed to consist of the consolidated net assets of TFG Asset Management L.P. calculated in accordance with U.S. GAAP, the current carrying value of the management contracts and the fair value of the investment in GreenOak, with the remaining net assets being attributed to the Investment Portfolio segment.

	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	<b>US\$ '000</b>	<b>US\$ '000</b>
Investment Portfolio	1,760,538	1,584,247
Asset Management	86,193	74,029
<b>Total</b>	<b>1,846,731</b>	<b>1,658,276</b>

# TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

### Note 19 Share Based Employee Compensation and Bargain Purchase

On 28 October 2012, TFG Asset Management L.P. (formerly known as Polygon Management L.P.) and certain of its affiliates, were acquired in exchange for consideration of approximately 11.7 million non-voting shares of the Feeder to the sellers (the "Aggregate Consideration"). The Aggregate Consideration will be held in escrow (along with accrued stock dividends), by the escrow agent pursuant to the terms of the escrow agreement, until it is released over the period from 2013 to 2017.

Under ASC 805 - Business Combinations ("ASC 805") these shares were treated as payment for post combination services rather than upfront consideration, hence the initial consideration was determined to be nil, resulting in a bargain purchase.

The assets and liabilities purchased were separately identified and an estimated fair value was calculated as at the acquisition date. The management contracts were classified as either Hedge Funds or Private Equity and an estimated fair value for these intangible assets was calculated by reference to applicable market methodologies such as percentage of assets under management, discounted cash flow analysis and price-earnings ratios. The 13% interest in GreenOak was not consolidated, but classified as an investment to be held at fair value. This was also valued by reference to similar applicable market methodologies. As part of the transaction, the noncontrolling interest in LCM was treated as a transaction with the Fund in its capacity as owners and therefore no separate asset or goodwill is recognised as a result. The following table summarizes the estimated fair value of the assets acquired against the consideration recognized:

	US\$ '000
<b>Assets</b>	
Management contracts – Hedge Funds	34,282
Management contracts – Private Equity	10,246
13% interest in GreenOak	10,246
LCM noncontrolling interest	-
	54,774
Net liabilities	-
<b>Total identifiable net assets assumed</b>	54,774
Consideration	-
<b>Bargain purchase recognized in the consolidated statement of operation</b>	54,774

The overall value of the Aggregate Consideration delivered to the escrow account for the sellers amounted to US\$ 98.5 million based on a share price of US\$ 8.43 at the close on the last business day prior to the transaction date. Polygon was acquired free of cash and debt.

The shares exchanged are subject to vesting and forfeiture conditions: in particular, all of the consideration due to Reade Griffith and Paddy Dear, Founders of Polygon, will vest between 2015 and 2017.

As the consideration is treated as share based payments under ASC 805, the Fund recognizes the individual compensation costs on a straight line basis over the relevant service period of each award if the vesting performance conditions are met. These are reflected in the Statements of Operations as share based employee compensation and through Equity as a separate reserve. The charge for the year ended 31 December 2013 amounted to US\$ 23.1 million (31 December 2012: US\$ 3.8 million).

The table below shows the number of Feeder shares which are currently expected to vest over the period to 2017, including accrued stock dividends up to the end of 2013. These shares are all entitled to any future stock dividends prior to their release from escrow and so the actual amount of shares vesting each year may be higher. Upon the release of the Feeder shares from escrow, the Fund will issue an identical number of Shares to the Feeder. During the year 1,165,012 Feeder shares were released from escrow and the same number of Shares were issued from the Fund to the Feeder.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 19 Share Based Employee Compensation and Bargain Purchase (continued)

Of the Shares released, 1,108,219 were Shares originally granted, and 56,793 were accrued stock dividends. In relation to the release of the aforementioned original Shares, a value of US\$ 9.3 million has been debited to the applicable reserve in Equity and the imputed value of the stock dividends of US\$ 0.6 million has been debited to retained earnings.

#### Vesting Schedule - Shares

	Shares '000	US\$ '000
2014	1,464	23,096
2015	3,988	23,097
2016	3,164	16,586
2017	2,665	12,637
	<hr/>	<hr/>
	11,281	75,416

#### Note 20 Contingencies and Commitments

The Fund committed to provide a co-investment commitment of up to US\$ 100.0 million into GreenOak investment vehicles. As at 31 December 2013, it had funded US\$ 26.3 million of this commitment, (31 December 2012: US\$ 13.4 million). The Fund has made investment commitments in several existing vehicles where only a partial capital drawdown has occurred to date. The Fund has estimated unfunded commitments of up to US\$ 31.8 million in this respect (31 December 2012: US\$ 36.9 million).

Future minimum lease payments under noncancelable operating leases as of 31 December 2013 are:

Year ending 31 December:	US\$'000
2014	5,714
2015	5,714
2016	5,714
2017	4,953
2018	208
	<hr/>
	22,303

During 2013, the amount paid with respect to such leases was US\$ 5.1 million.

#### Note 21 Related Party Transactions

The Feeder, a Guernsey based closed-ended investment company, invests substantially all of its assets in the Fund, and has the same Investment Manager as the Fund.

All fees and expenses of the Feeder and the Fund (including management fees), except for the incentive fees, are paid by the Fund and allocated to the Feeder. An incentive fee may be paid to the Investment Manager by the Feeder.

The remuneration for Directors shall be determined by resolution of the Voting Shareholder. Each of the Directors' annual fee is US\$ 75,000 in compensation for service on the Boards of Directors of both the Feeder and the Fund. The Fund will pay the Directors' fees. Paddy Dear and Reade Griffith have waived their entitlement to a fee in respect of their services as Directors. The Directors are entitled to be repaid by the Fund for all travel, hotel and other expenses reasonably incurred by them in the discharge of their duties. None of the Directors has a contract with the Feeder or the Fund providing for benefits upon termination of employment.



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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 21 Related Party Transactions (continued)

The Voting Shareholder, which holds all of the voting shares, was an affiliate of Polygon and continues to be an affiliate of the Investment Manager. As a result of its ownership and the degree of control that it exercises, the Voting Shareholder will be able to control the appointment and removal of the Fund and Feeder's Directors (subject to applicable law). Affiliates of the Voting Shareholder also control the Investment Manager and, accordingly, control the Fund's business and affairs.

As described in Note 1, Polygon Management L.P. (now known as TFG Asset Management L.P.), including Polygon's asset management businesses and infrastructure platform and interests in LCM and GreenOak, were acquired on 28 October 2012. As part of the Acquisition, Reade Griffith and Paddy Dear, as founders of Polygon, were awarded consideration in non-voting shares of the Feeder, which vest between 2015 and 2017.

It was contractually agreed as part of the Acquisition that to the extent any annual compensation actually paid to each of Mr. Griffith and Mr. Dear in respect of his employment with the Fund exceeds an annual base salary of US\$ 100,000, they would promptly return such excess amount to the Fund. During the year ended 31 December 2013 total compensation paid to them each in aggregate was US\$ 100,000.

As at 31 December 2013, in connection to the Acquisition, US\$ 6.9 million in aggregate is owed to Reade Griffith and Paddy Dear, directly or via an entity to which they may direct payment (31 December 2012: US\$ 7.0 million). This payable primarily relates to the repayment of certain rent deposits and other working capital funded through Polygon entities by Messrs Griffith and Dear before the Acquisition. Under the terms of the sale and purchase agreement relating to the Acquisition, Messrs Griffith and Dear retained the economic rights to such deposits.

Reade Griffith and Paddy Dear continue to hold membership interests in Polygon Global Partners LLP (the "U.K. Investment Manager") which collectively entitle them to exercise all of the voting rights in respect of the U.K. Investment Manager. As part of the Acquisition, each of Mr. Griffith and Mr. Dear have agreed that he will (i) exercise his voting rights in a manner that is consistent with the best interests of the Fund and (ii) upon the request of the Fund, for nominal consideration, sell, transfer and deliver his membership interests in the U.K. Investment Manager to the Fund.

Polygon Global Partners LLP and Polygon Global Partners LP (the "Service Providers") provide operational, financial control, trading, marketing and investor relations, legal, compliance, administrative, payroll and employee benefits and other services to the Investment Manager in exchange for fees payable by the Investment Manager to the Services Providers. In addition, the Services Providers also provide certain operating, infrastructure and administrative services to LCM, GreenOak and Polygon Private Investment Partners LP, an affiliate of the Voting Shareholder, pursuant to applicable separate services agreements. PGP LLP is authorized and regulated by the United Kingdom Financial Conduct Authority. In the period the amount recharged to these entities was US\$ 19.4 million (31 December 2012: US\$ 6.7 million). As at 31 December 2013, the amount receivable relating to these recharges was US\$ 1.9 million (31 December 2012: US\$ 2.2 million).

The Fund holds CLO equity investments in CLOs which are managed by LCM. During the year it purchased a portion of the equity tranche in LCM XIII at a total cost of US\$ 24.6 million and a portion of equity tranche in LCM XIV at a total cost of US\$ 1.0 million. In total, as at 31 December 2013, it held CLO equity tranche investments in 11 CLOs managed by LCM with a fair value of US\$ 159.6 million (31 December 2012: US\$ 190.2 million).

At 31 December 2013, the Fund held investments across several hedge funds managed by Polygon. These hedge funds employ investment strategies involving investing in equities, convertible bonds, credit and derivatives. As at 31 December 2013, the fair value of these investments was US\$ 265.3 million (31 December 2012: US\$ 56.5 million). The fees paid on these investments are disclosed as per Note 17.

The Fund owns a 23% equity interest in GreenOak. As part of the original transaction to acquire a share in GreenOak, the Fund provided a US\$ 100.0 million coinvestment commitment and a US\$ 10.0 million working capital loan commitment to GreenOak, with the Feeder issuing 3.9 million share options to the GreenOak founders. On 28 October 2012, as a result of the Acquisition the Fund increased its working capital loan commitment by an additional US\$ 0.5 million by assuming the acquiree's remaining unfunded commitment.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### Note 21 Related Party Transactions (continued)

The Fund has made investments across several real estate investment vehicles managed by GreenOak. As at 31 December 2013, these investments referenced real estate in the United States, Japan and United Kingdom with a net asset value of US\$ 60.8 million (31 December 2012: US\$ 25.7 million). These investments are typically illiquid where the Fund will only receive distributions on liquidation of the investment vehicle's underlying assets and in some cases this may not be for several years. In addition, based on projected capital raised (subject to change), the Fund had estimated unfunded commitments of up to US\$ 31.8 million with respect to the investment vehicles (31 December 2012: US\$ 36.9 million).

#### Note 22 Other Matters

On 18 June 2013, a shareholder derivative action was filed in United States District Court – Southern District of New York – against the six directors of the Fund and the Feeder, the Investment Manager, the principals of the Investment Manager and other affiliated entities by a purported shareholder of the Feeder (the "Action").

The Action makes a series of allegations including with respect to the Acquisition (see Note 21) and asks, amongst other things, for money damages and equitable relief against the defendants, including the termination of the investment management agreement among the Fund, the Feeder and the Investment Manager.

The Feeder, the Fund and their Board of Directors have stated that they believe that the Action is factually and legally without merit and intend to seek to have the Action dismissed as quickly as possible. On 13 January 2014, all defendants filed a motion to dismiss the Action in its entirety.

On 22 February 2011, the Fund and the Feeder and their six directors were served with proceedings in the Royal Court of Guernsey (the "Guernsey Proceedings") instigated by one of the Fund's former directors, Alexander Jackson, seeking to impugn the Fund's decision to enter into a joint venture with GreenOak. On 26 March 2013, Lieutenant Bailiff Patrick Talbot of the Royal Court of Guernsey dismissed the Guernsey Proceedings having determined that the entire claim should be struck out as an abuse of process as no aspect of it satisfied the standard for bringing such a derivative action in Guernsey. Lieutenant Bailiff Talbot also awarded costs against Mr. Jackson. On 10 September 2013, the Court of Appeal of the Island of Guernsey ordered the discontinuance of Mr. Jackson's appeal of the Guernsey Proceedings, Mr. Jackson having paid costs of such appeal.

On 1 March 2013, the English Court of Appeal dismissed in its entirety a claim filed by Mr. Jackson against Paddy Dear and Reade Griffith in the High Court in London (the "English Proceedings") regarding Mr. Jackson's removal in January 2011 from the Board of Directors of the Fund and the Feeder and awarded costs against Mr. Jackson.

During the year, the Fund incurred gross legal expenses of US\$ 11.6 million in connection with the aforementioned Guernsey Proceedings, English Proceedings and Action, which includes amounts paid under applicable indemnification provisions with respect to the Directors, the Investment Manager and principals of the Investment Manager. Against these gross expenses US\$ 4.9 million was received from Mr. Jackson and US\$ 2.1 million was reclaimed from the insurers, resulting in a net expense for the year of US\$ 4.6 million. At 31 December 2013, US\$ 1.4 million (31 December 2012: US\$ 0.1 million) was accrued as payable in the Consolidated Statements of Assets and Liabilities.

The Fund is seeking to recover from insurers costs relating to a previous shareholder derivative action, details of which were referred to in the 2011 and 2012 Fund consolidated financial statements. Currently significant uncertainty remains as to what will be recoverable from these efforts and therefore a receivable has not been recognized in the statements of assets and liabilities.

The Directors have evaluated subsequent events up to 26 February 2014, which is the date that the consolidated financial statements were approved, and have concluded that there are not any material events that require disclosure or adjustment to the consolidated financial statements.

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## TETRAGON FINANCIAL GROUP MASTER FUND LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued) For the year ended 31 December 2013

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#### **Note 23 Subsequent Events**

On 10 February 2014, the Fund and the Feeder announced the commencement of a tender offer (the “Offer”) to purchase a portion of the non-voting shares of the Feeder for a maximum aggregate payment of US\$50.0 million in cash. The Offer will be conducted as a “modified Dutch auction” with Shareholders able to tender their shares at prices ranging from US\$ 10.30 up to and including US\$ 11.50 per share (in increments of US\$0.10). The Offer, which is expected to expire at 11:59 p.m. Eastern Daylight Time on 10 March 2014, unless terminated earlier, is more fully described in the Offer to Purchase, which may be found on the Feeder’s website.

#### **Note 24 Recent Changes to U.S. GAAP**

In June 2013, the FASB issued ASU No. 2013-08, “Financial Services - Investment Companies (Topic 946) - Amendments to the Scope, Measurement, and Disclosure Requirements.” ASU No. 2013-08 clarifies the approach to be used for determining whether an entity is an investment company and provides new measurement and disclosure requirements. ASU No. 2013-08 is effective for interim and annual reporting periods in fiscal years that begin after 15 December 2013. Earlier application is prohibited. Adoption of ASU No. 2013-08 is not expected to materially affect the Company’s financial condition, results of operations, or cash flows.

#### **Note 25 Approval of Financial Statements**

The Directors approved the consolidated financial statements on 26 February 2014.