**July 31, 2012**

Tetragon Financial Group Limited (TFG) is a Guernsey closed-ended investment company traded on NYSE Euronext in Amsterdam under the ticker symbol “TFG.” ([[1]](#endnote-1)) In this report we provide an update on TFG’s results of operations for the period ending June 30, 2012.

* **Executive Summary:**

**Q2 2012 saw another strong set of quarterly results, with U.S. CLO performance leading the way.**

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| * **Earnings per Share:** TFG generated EPS of $0.69 during Q2 2012 (Q1 2012: $0.46). | * **Distributions:** TFG declared a Q2 2012 dividend of $0.115 per share, up from Q1 2012. Inclusive of the Q2 dividend, the rolling 12-month dividend growth rate (year-on-year) was 18.1%. The company also used over $7.8 million to buy back shares below NAV during the quarter. | * **Net Asset Value (“NAV”):** Rose to $1,570.3 million or $13.75 per share at the end of Q2 2012, the highest level to date, and an increase of 4.8%, on a per share basis, from Q1 2012. |

*Figure 1* below shows an historical summary of TFG’s Net Assets, NAV per share and share price.



1. Source: NAV per share based on TFG’s financial statements as of the relevant quarter-end date; TFG’s closing share price data as per Bloomberg as of the last trading day of each quarter. Please note that the NAV per share reported as of each quarter-end date excludes any shares held in treasury as of that date.

* **Net Income:** Consolidated net income of $79.2 million for Q2 2012 (Q1 2012: consolidated net income of $53.4 million).

This Performance Report constitutes TFG’s half-yearly financial report as required pursuant to Section 5:25d of the FMSA. Pursuant to Section 5:25d and 5:25m of the FMSA, this report is made public by means of a press release and has been filed with the Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten) and also made available to the public by way of publication on the TFG website (www.tetragoninv.com).

* **Executive Summary (continued)**:
* **Asset Breakdown:** The figures below illustrate the split of net assets by asset class at the end of Q2 2012 ($1,570,273,629) and Q1 2012 ($1,510,100,263), respectively.



**Investment Portfolio Performance Highlights**

**TFG’s U.S. CLOs continue to outperform in terms of collateral performance, providing the catalyst for strong Q2 2012 results.**

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| * **Cash Flows:** TFG generated $110.0 million of cash flows from its CLO equity investment portfolio in Q2 2012 (Q1 2012: $102.6 million). | * **Collateral Performance:** TFG’s average CLO portfolio statistics performed well during Q2 2012 with low default and CCC-asset holding levels. This was driven by continued improvements in the credit quality of TFG’s U.S. CLOs, which offset the credit deterioration experienced by TFG’s European CLOs. | * **CLO Returns:** Weighted-average IRRs on CLO equity investments remained broadly unchanged at 17.6% (Q1 2012: 17.5%) with U.S. CLO average IRRs remaining at 19.7% while the average IRR of TFG’s European CLOs increased to 8.0% (Q1 2012: 7.9%). |

* **Executive Summary (continued):**

**Investment Portfolio Performance Highlights (continued):**

*Figure 3* below shows an historical summary of the weighted-average IRR on TFG’s CLO equity investments.



1. Source: TFG as of the outlined quarter-end date.

* **New CLO Equity Investments:** During Q2 2012, LCM XI, a new issue CLO managed by LCM, was successfully closed. TFG invested $22.7 million in the equity tranche of this transaction, representing a majority position of the tranche.
* **Direct Loans:** TFG held direct loans with a fair value of $87.4 million at the end of Q2 2012, down from $120.3 million as of the end of Q1 2012. Overall, the direct loan portfolio performed in-line with expectations during this period experiencing no defaults.
* **Real Estate Investments:**  During Q2 2012, TFG invested a further $0.7 million into GreenOak-managed real estate. The total amount of capital invested in GreenOak-managed real estate since inception is approximately $8.2 million as of the end of the second quarter.

We continue to seek to diversify the investment portfolio across asset classes and types, industries, geographies and investment duration.

* **Executive Summary (continued):**

**Asset Management Segment: Third-party AUM continues to grow.**

We believe that TFG owning or having stakes in asset management businesses may provide repeatable income streams and reduce fees paid to third-party managers.

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| **LCM:** LCM continued to perform well during Q2 2012, with all LCM Cash Flow CLOs ([[2]](#endnote-2)) that were still within their reinvestment periods ([[3]](#endnote-3)) continuing to pay senior and subordinated management fees. With the addition of LCM XI, LCM’s total loan assets under management rose to approximately $4.1 billion (Q1 2012: $3.7 billion). |  |

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| **GreenOak:** GreenOak continued to execute on its business growth strategy, including increasing investor commitments to its funds. |  |

* **Corporate-Level Performance Details:**
* **Capital Distributions**: TFG’s Board approved a dividend of $0.115 per share with respect to Q2 2012, an increase from the prior quarter. As of June 30, 2012, inclusive of the dividend declared with respect to Q2 2012, the rolling 12-month dividend growth rate (year-on-year) was 18.1%.([[4]](#endnote-4))

Since its public listing TFG has distributed or declared a cumulative amount of approximately $2.01 per share via quarterly dividends. In addition, TFG’s NAV per share, as reported each quarter, among other things, reflects value created for shareholders via the repurchase of shares below NAV. During Q2 2012, TFG repurchased a total of 1,063,825 shares at an aggregate cost of approximately $7.8 million, at an average price of $7.34 per share. Since the inception of the buy-back program, TFG has repurchased a total of 18,521,994 shares, at an aggregate cost of approximately $98.9 million, at an average price of $5.34 per share. Please refer to *Figure 6* and *Figure 7* for a summary of TFG’s historical NAV per share, dividend distributions, and share buy-back program.



1. Source: NAV per share and Cumulative DPS as per TFG’s financial disclosures for each relevant quarter-end date. The cumulative DPS reflect dividends announced with respect to each relevant quarter. Please note that dividends announced with respect to each quarter are typically not distributed to shareholders until the beginning of the following quarter. Please note further that the NAV per share reported as of each quarter-end date excludes any shares held in treasury as of that date.

* **Corporate-Level Performance Details (continued):**
* **Capital Distributions (continued):**



1. The Average Purchase Price of Shares Repurchased is a weighted-average using the number of shares repurchased each quarter and including commissions.

* **Performance Fee**

A performance fee of $22.5 million was accrued in Q2 2012 in accordance with TFG’s investment management agreement and based on a “Reference NAV” of Q1 2012. The hurdle rate for the Q3 2012 incentive fee has been reset at 3.1085% (Q2 2012: 3.1160%) as per the process outlined in TFG’s 2011 Audited Financial Statements and in accordance with TFG’s investment management agreement.([[5]](#endnote-5))

* **Investment Portfolio Performance Details:**
* **CLO Portfolio Size:** At the end of Q2 2012, the estimated total fair value of TFG’s CLO equity investment portfolio was approximately $1,177.0 million ($1,061.6 million of U.S. and $115.4 million of European investments), up from $1,160.3 million as of the end of the prior quarter ($1,044.1 million of U.S. and $116.2 million of European investments). TFG’s total indirect exposure to leveraged loans through its CLO equity investments was approximately $18.9 billion as ofthe end of Q2 2012.([[6]](#endnote-6))
* **CLO Portfolio Composition:** 79 transactions as of the end of Q2 2012, up from 78 as of the end of the prior quarter, reflecting the closing of one new issue CLO equity investment. The number of deals in the portfolio increased to 70 from 69 as of the end of the prior quarter. The number of external CLO managers remained unchanged from Q1 2012, at 27.([[7]](#endnote-7))
  + - **CLO Collateral Performance:** At the end of Q2 2012, approximately 98% of TFG’s CLO investments were passing their junior-most O/C tests, weighted by fair value.([[8]](#endnote-8)) Similarly, 66 or approximately 94% were passing when weighted by the number of deals. At the end of the previous quarter, 97% of TFG’s CLO investments were passing their junior-most O/C tests, weighted by fair value, or 64 and 93% when weighted by the number of deals.

100% of TFG’s U.S. CLOs were passing their junior-most O/C tests as of June 30, 2012 (note that U.S. CLOs represented approximately 90% of the total fair value of TFG’s CLO equity investment portfolio).([[9]](#endnote-9))([[10]](#endnote-10)) In comparison, the market-wide average of U.S. CLOs estimated to be passing their junior O/C tests as of the end of Q2 2012 was approximately 95.8% (when measured on a percentage of deals basis).([[11]](#endnote-11)) Please refer to *Figure 8* below for a summary of TFG’s investments’ historical junior O/C test performance.



1. The percentage of TFG’s CLOs passing their junior-most O/C tests has been calculated as the ratio of the number of deals passing their junior O/C tests to the total number of CLO deals held by TFG as of the applicable quarter-end date.
2. Gross Cash Receipts from Investments refer to the actual cash receipts collected during each quarter from TFG’s CLO investments. Cash Flows from Operations refer to cash inflows from investments less expenses and net cash settlements on FX and credit hedges.

* **Investment Portfolio Performance Details (continued):**
* **CLO Portfolio Credit Quality:** The weighted-average WARF across all of TFG’s CLO equity investments stood at approximately 2,578 as of the end of Q2 2012. Each of these foregoing statistics represents a weighted-average summary of all of our 70 deals.([[12]](#endnote-12)) Each individual deal’s metrics will differ from these averages and vary across the portfolio.

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| **ALL CLOs** | **Q2 2012** | **Q1 2012** | **Q4 2011** | **Q3 2011** | **Q2 2011** | **Q1 2011** | **Q4 2010** | **Q3 2010** | **Q2 2010** | **Q1 2010** | **Q4 2009** | **Q3 2009** | **Q2 2009** |
| Caa1/CCC+ or Below Obligors: | 5.7% | 6.2% | 7.0% | 7.0% | 7.2% | 7.6% | 8.3% | 9.6% | 10.5% | 11.1% | 12.0% | 12.6% | 11.6% |
| WARF: | 2,578 | 2,588 | 2,624 | 2,614 | 2,642 | 2,664 | 2,671 | 2,658 | 2,706 | 2,762 | 2,809 | 2,813 | 2,800 |

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| **US CLOs** | **Q2 2012** | **Q1 2012** | **Q4 2011** | **Q3 2011** | **Q2 2011** | **Q1 2011** | **Q4 2010** | **Q3 2010** | **Q2 2010** | **Q1 2010** | **Q4 2009** | **Q3 2009** | **Q2 2009** |
| Caa1/CCC+ or Below Obligors: | 4.2% | 4.8% | 5.5% | 5.5% | 5.8% | 6.5% | 6.9% | 7.9% | 8.4% | 9.4% | 12.0% | 12.8% | 11.9% |
| WARF: | 2,491 | 2,504 | 2,533 | 2,522 | 2,542 | 2,591 | 2,622 | 2,610 | 2,648 | 2,719 | 2,799 | 2,824 | 2,831 |

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| **EUR CLOs** | **Q2 2012** | **Q1 2012** | **Q4 2011** | **Q3 2011** | **Q2 2011** | **Q1 2011** | **Q4 2010** | **Q3 2010** | **Q2 2010** | **Q1 2010** | **Q4 2009** | **Q3 2009** | **Q2 2009** |
| Caa1/CCC+ or Below Obligors: | 11.6% | 11.1% | 12.3% | 12.0% | 12.3% | 11.4% | 13.1% | 15.3% | 17.4% | 16.8% | 15.6% | 12.0% | 10.8% |
| WARF: | 2,910 | 2,900 | 2,948 | 2,941 | 2,997 | 2,914 | 2,837 | 2,817 | 2,898 | 2,907 | 2,845 | 2,779 | 2,696 |

* **TFG and Market Default Rates:** TFG’s lagging 12-month corporate loan default rate rose marginally to 0.9% during Q2 2012, from 0.8% the prior quarter.([[13]](#endnote-13)) By geography, TFG’s U.S. CLO equity and direct loan investments registered a lagging 12-month default rate of 0.6%, with European CLO equity investments at 2.8%. By comparison, the lagging 12-month U.S. institutional loan default rate rose to 1.04% by principal amount as of June 30, 2012, according to S&P/LCD, up from approximately 0.21% during the prior quarter.([[14]](#endnote-14)) The lagging 12-month default rate for the S&P European Leveraged Loan Index (“ELLI”) stood 5.5% as of the end of June 30, 2012.([[15]](#endnote-15)) Please refer to *Figure 9* on the following page for a historical summary of TFG’s CLO equity and direct loan investments’ default performance.
* **Investment Portfolio Performance Details (continued):**



(i) Source: TFG as of the outlined quarter-end date. The calculation of TFG’s lagging 12-month corporate loan default rate does not include certain underlying investment collateral that was assigned a “Selective Default” rating by one or more of the applicable rating agencies. Such Selected Defaults are included the S&P/LCD lagging 12-month U.S. institutional loan default rate discussed above. Furthermore, TFG’s CLO equity and direct loan investment portfolio includes approximately 9.1% CLOs with primary exposure to European senior secured loans and such loans are included in the calculation of TFG’s corporate default rate.

(ii) Source: S&P/LCD Quarterly Review as of the outlined quarter-end date.

* **Direct Loan Investments:** As of June 30, 2012, TFG owned liquid U.S. bank loans with an aggregate par amount of approximately $88.8 million and total fair value of $87.4 million. The size of the portfolio was reduced during the second quarter in order to, among other factors, de-risk the portfolio ahead of a potential further deterioration of European macroeconomic conditions on the heels of the Greek sovereign debt crisis. All positions were sold above their original purchase prices. The underlying businesses performed well during the quarter, with the loan portfolio trading at approximately 98% of par compared with an average purchase price of 98% of par, and with no defaults registered in the portfolio. For the quarter, there were net realized losses of approximately $0.1 million. In addition, the portfolio earned $1.5 million of interest income and discount premium during the second quarter.
* **Real Estate Investments:** TFG has funded a small portion of its investment capital commitments to GreenOak’s investment projects, totaling approximately $8.2 million from inception through the end of Q2 2012 to finance investments in Japan, the United States and Europe.
* **Asset Management Platform Details:**
* **LCM Developments**: LCM’s operating results and financial performance remained strong throughout Q2 2012, with all LCM Cash Flow CLOs that were within their reinvestment periods ([[16]](#endnote-16)) remaining current on their senior and subordinated management fees as of June 30, 2012.Taking into account all LCM-managed vehicles, the gross income for Q2 2012 for LCM totaled $4.4 million. Pre-tax profit for the entire LCM business, of which TFG owns 75%, was approximately $2.1 million as of the same period (2011 quarterly average of $2.1 million). TFG continues to leverage and benefit from the LCM team’s expertise in the ongoing management of the company’s direct loan investment portfolio.

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| **LCM Asset Management Performance Snapshot** | | | | | | | | | | |
|  | **Q2 2012** | **Q1 2012** | **Q4 2011** | **Q3 2011** | **Q2 2011** | **Q1 2011** | **Q4 2010** | **Q3 2010** | **Q2 2010** | **Q1 2010** |
| Gross Fee Income ($MM) | $4.4 | $4.4 | $4.3 | $4.4 | $3.9 | $3.8 | $3.4 | $3.0 | $2.9 | $3.3 |
| Pre-tax Income ($MM) | $2.1 | $2.0 | $2.2 | $2.2 | $1.9 | $1.9 | $1.1 | $1.4 | $1.4 | $1.9 |

* **GreenOak Real Estate Developments:** GreenOak continued to execute on its business growth strategy, including increasing investor commitments to its funds. The company had a second closing of its Japan fund in June 2012 and also acquired its first investment for the Japan fund during the quarter. GreenOak’s investment team is actively building a pipeline of interesting opportunities in the United States, Japan, and Europe, which we expect to continue to materialize over the next several quarters.

We continue to seek to grow and expand our asset management businesses and capabilities as we further our efforts to transition the company to a broadly diversified financial services firm that benefits from diverse income streams. We continue to review potential market opportunities in this regard.

* **Loan and CLO Market Developments:**
* **U.S. leveraged loan defaults up during Q2 2012, but below the historical average:** The U.S. lagged 12-month loan default rate rose to 1.04% by principal amount as of June 30, 2012, up from 0.21% as of the end of Q1 2012.([[17]](#endnote-17)) Despite reaching a near-term high, the U.S. leveraged loan default rate remained below the historical average of approximately 3.4% by principal amount. ([[18]](#endnote-18))
* **U.S. and European repayments rise:** TheU.S. S&P/LSTA Leveraged Loan Index repayment rate rose to 8.2% during Q2 2012, up from 7.6% in Q1 2012.([[19]](#endnote-19)) Repayments within the S&P European Leveraged Loan Index (“ELLI”) rose to €6.0 billion during Q2 2012, up from €2.9 billion in Q1 2012.([[20]](#endnote-20))
* **“Maturity wall” reduction continues:** During Q2 2012, U.S. S&P/LSTA Index issuers repaid or extended approximately 23.2% of loan maturities due by the end of 2014, up from 21.2% in Q1 2012.([[21]](#endnote-21)) The majority of these reductions was achieved via repayments, with amend-to-extends and high yield bond take-outs constituting a smaller share of maturity reduction sources during the quarter.([[22]](#endnote-22))
* **U.S. and Euro loan returns positive despite macro uncertainty:** U.S. secondary loan prices struggled to hold-on to early gains, as the U.S. S&P/LSTA Leveraged Loan Index returned a modest 0.69% in Q2 2012.([[23]](#endnote-23)) Similarly, the S&P European Leveraged Loan Index returned 0.55%, as worries about the Euro sovereign debt crisis and viability of the U.S. recovery weighed on the markets.([[24]](#endnote-24))
* **U.S. loan issuance down, European volumes up but still subdued:** Institutional U.S. loan issuance declined to $56.6 billion in Q2 2012, down from $68.0 billion in Q1 2012.([[25]](#endnote-25)) European primary institutional loan issuance rose modestly with €4.3 billion of institutional loans issued in Q2 2012 compared with €3.6 billion in Q1 2012, but remained low by historical standards.([[26]](#endnote-26))
* **U.S. CLO O/C ratios improve while European deals remain under pressure:** During Q2 2012, O/C ratios of U.S. CLOs strengthened on average. According to Morgan Stanley, the median junior O/C test cushion for U.S. CLOs rose to 4.37% as of June 30, 2012 ([[27]](#endnote-27)) up from 4.09% as of the end of the prior quarter.([[28]](#endnote-28)) The median junior O/C test cushion for European CLOs, however, declined to 0.77% as of the end of Q2 2012, ([[29]](#endnote-29)) down from 0.95% as of the end of Q1 2012.([[30]](#endnote-30))
* **U.S. CLO debt spreads widen**: Average secondary U.S. CLO debt spreads widened marginally at the end of Q2 2012 vs. the prior quarter reflecting a broader risk-off move in the capital markets.([[31]](#endnote-31))
* **Primary arbitrage CLO volumes up in Q2 2012 despite challenging markets:** U.S. arbitrage CLO issuance rose during Q2 2012 as 27 deals totaling $12.1 billion were priced, up from $5.8 billion and 15 deals priced in Q1 2012, bringing the YTD volume to $17.9 billion via 42 deals.([[32]](#endnote-32)) The CLO market showed resilience during the quarter in the face of weakening macro conditions, rising volatility and widening CLO liability spreads. Although the forward CLO pipeline is robust, the pace of issuance may decelerate during the second half as deal execution becomes more opportunistic, reflecting the unpredictability of the capital markets, volatility of CLO and loan spreads, and fickle equity arbitrage.
* **U.S. CLO equity distributions remain robust:** U.S. CLO equity payments remained strong during Q2 2012 thanks to low credit losses, the growing prevalence of LIBOR floors, and healthy repayments which allowed managers to reinvest into wider spread and/or below par assets, among other factors.
* **Fair Value Determination for TFG’s CLO Equity Investments:**
* In accordance with the valuation policies as set forth on the company’s website, the values of TFG’s CLO equity investments are 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 TFG’s 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.
* Subject to the foregoing, when determining the U.S. GAAP-compliant fair value of TFG’s portfolio, the company 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. Please refer to the 2011 Annual Report for a more detailed description of the cash flow projection and discounting process.
* **Forward-looking CLO Equity Cash Flow Modeling Assumptions:**
* The Investment Manager reviews, and adjusts in consultation with TFG’s audit committee, as appropriate, the CLO equity investment portfolio’s modeling assumptions as described above. At the end of Q2 2012, key assumptions relating to defaults, recoveries, prepayments and reinvestment prices were unchanged from the previous quarter.
* These key average assumption variables have been summarized in the table below. 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). Such weighted averages may change from month to month due to movements in the amortized costs of the deals, even without changes to the underlying assumptions. Each individual deal’s assumptions may differ from this geographical average and vary across the portfolio.
* In addition to the reinvestment price, reinvestment spread and reinvestment life assumptions are also input into the model to generate an effective spread over LIBOR.   Newer vintage CLOs may have a higher weighted average reinvestment spread over LIBOR (as of the end of Q2 2012 385 bps for newer vintage CLOs and 274 bps for older vintage CLOs) or shorter reinvestment life assumptions than older deals. Across the entire CLO portfolio, the reinvestment price assumption of 98% for the remainder of 2012 for U.S. deals and 100% for European deals with their respective assumed weighted-average reinvestment spreads, generates an effective spread over LIBOR of approximately 365 bps on broadly syndicated U.S. loans, 288 bps on European loans, and 422 bps on middle market loans.([[33]](#endnote-33))
* **Forward-looking CLO Equity Cash Flow Modeling Assumptions (continued):**

**U.S. CLOs – Unchanged**

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| --- | --- | --- |
| **Variable** | **Year** | **Current Assumptions** |
| **CADR** | | |
|  | **2012-2013** | 1.0x WARF-implied default rate (2.2%) |
|  | **2014-2016** | 1.5x WARF-implied default rate (3.3%) |
|  | **Thereafter** | 1.0x WARF-implied default rate (2.2%) |
| **Recovery Rate** | | |
|  | **Until deal maturity** | 73% |
| **Prepayment Rate** | | |
|  | **Until deal maturity** | 20.0% p.a. on loans; 0.0% on bonds |
| **Reinvestment Price** | | |
|  | **2012** | 98% |
|  | **Thereafter** | 100% |

**European CLOs - Unchanged**

|  |  |  |
| --- | --- | --- |
| **Variable** | **Year** | **Current Assumptions** |
| **CADR** | | |
|  | **2012-2014** | 1.5x WARF-implied default rate (3.1%) |
|  | **Thereafter** | 1.0x WARF-implied default rate (2.1%) |
| **Recovery Rate** | | |
|  | **Until deal maturity** | 68% |
| **Prepayment Rate** | | |
|  | **Until deal maturity** | 20.0% p.a. on loans; 0.0% on bonds |
| **Reinvestment Price** | | |
|  | **Until deal maturity** | 100% |

* **Application of Discount Rate to Projected CLO Equity Cash Flows and ALR:**
* In determining the applicable rates to use to discount projected cash flows, an analysis of observable risk premium data is undertaken. During Q2 2012 certain observable data and research, covering both CLO equity and debt tranches (including originally BB and BBB-rated debt tranches), suggested that risk premia on U.S. CLO equity marginally increased. For example, according to Citibank research, the spread on originally BB-rated tranches increased from approximately 10% at the end of Q1 2012 to 11% as of June 2012.([[34]](#endnote-34))
* Although the aforementioned spreads increased marginally over the quarter, they continue to fluctuate within a relatively narrow range and we believe that TFG’s discount rates for U.S. CLOs of 20% for strong deals, and 25% for the others, continue to represent an appropriate spread over mezzanine tranches.
* Per Citibank research, European originally BB-rated tranche yields rose to 22% from 21% as of June 2012, which is lower than the yield of 24% at the end of 2011.([[35]](#endnote-35)) These spreads are still significantly above the equivalent U.S. CLO debt tranches and given the ongoing uncertainty surrounding Europe, we believe that there is sufficient support to maintain TFG’s differentiated discount rate for all European deals at 30%.
* As a general rule, where the discount rate being applied to the future cash flows is greater than the IRR on a particular deal, the fair value for that deal will be lower than its amortized cost. The difference between these two figures, on an aggregate basis across the CLO equity portfolio, has been characterized as the “ALR Fair Value Adjustment” or “ALR”. Through the process described above, as of the end of Q2 2012, the total ALR stands at $109.3 million, consisting of $11.7 million for U.S. deals and $97.6 million for European deals, as compared to $120.7 million at the end of Q1 2012 ($16.5 million for U.S. deals and $104.2 million for European deals).
* The average carrying value of TFG’s U.S. CLO equity investments, which accounted for approximately 90.0% of the CLO equity investment portfolio by fair value, was approximately $0.77 on the dollar at the end of Q2 2012, the same level as at the end of Q1 2012.
* The average carrying value of the European deals rose from €0.40 per Euro as of the end of Q1 2012 to €0.42 per Euro as of the end of Q2 2012. This reflected, among other things, a recovery in the O/C cushions of some European deals, which all else being equal increase the value of future projected cash flows. It is important to note, however, that significant dispersion of carrying values exists across transactions within each geographic grouping, particularly in the case of Europe, with a range of carrying values of €0.06 to €0.62 per Euro.
* As discussed in the 2011 Annual Report, the applicable discount rate for the new vintage deals 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 end of Q2 2012, the weighted average discount rate (and IRR) on these deals was 10.4%. Such deals represented approximately 11.3% of the CLO equity portfolio by fair value (up from 9.4% at the end of Q1 2012). We will continue to monitor observable data on these newer vintage transactions to determine whether the IRR remains the appropriate discount rate.
* **Hedging Activity:**

As of June 30, 2012, TFG had no direct credit hedges in place, but employed certain foreign exchange rate and “tail risk” interest rate hedges to seek to mitigate its exposure to Euro-USD foreign exchange risk and a potential significant increase in U.S. inflation and/or nominal interest rates, respectively. We review our hedging strategy on an on-going basis as we seek to address identified risks to the extent practicable and in a cost-effective manner.

* **Directors’ Statements:**

The Directors of TFG confirm that (i) this Performance Report constitutes the TFG management review for the six month period ended 30 June 2012 and contains a fair review of that period and (ii) the financial statements in the accompanying unaudited interim report for the six month period ended 30 June 2012 for TFG have been prepared in accordance with applicable laws and in conformity with accounting principles generally accepted in the United States of America.

* **Summary and Outlook:**

TFG posted strong results during Q2 2012 and cash generation from the CLO portfolio remained robust. The U.S. CLO portfolio, which continues to benefit from, among other things, high spread reinvestment opportunities and low default rates (each of which have yet to revert to more normalized levels), drove NAV appreciation. In particular, pre-2010 vintage U.S. CLOs have also benefitted from their historically low cost of funding compared to newer vintage deals. Cash flow from our CLO equity investments has allowed for capital distributions through the dividend and the ongoing share buyback program.

TFG’s asset management businesses also performed well and added AUM during the quarter. We successfully closed LCM XI, a $486.0 million CLO. TFG invested approximately $22.7 million in the deal, with the remainder of the capital coming from third-party investors. GreenOak, TFG’s real estate management business, also added assets, with total assets under management ending the quarter at over $1.7 billion.

The regulatory and tax landscape continues to evolve and we are monitoring developments to assess their impact on TFG, including the impact of the Foreign Account Tax Compliance Act (“FACTA”), a U.S. tax regulation. Unfortunately, FATCA was not drafted with the CLO product in mind and accordingly, its application to CLOs remains unclear. We believe, however, that TFG and LCM will be able to avail themselves of certain FATCA provisions to alleviate its impact. We will continue to closely monitor the regulatory and tax environment as it relates to CLOs and securitizations.

Although Europe’s macroeconomic woes continue to provide headwinds, we are optimistic on the performance outlook for TFG. We believe the new issue CLO market may be conducive throughout the remainder of the year to new deals managed by well-established managers, such as LCM. This may serve to benefit both our investment portfolio, by allowing us to replace amortizing assets, and our CLO management business, by growing fee-paying third-party assets under management. As we have stated in the past, we remain focused on growing the company’s asset management business as we believe this may create value for the company’s shareholders by strengthening and diversifying TFG’s income streams.

* **Quarterly Investor Call:**

We will host a conference call for investors on August 8, 2012 at 15:00 GMT/16:00 CET/10:00 EST to discuss Q2 2012 results and to provide a company update.

The conference call may be accessed by dialing +44 (0)20 7162 0025 and +1 334 323 6201 (a passcode is not required). Participants may also register for the conference call in advance via the following link   
<https://eventreg1.conferencing.com/webportal3/reg.html?Acc=247751&Conf=184557>

Additional call details are as follows:

Event title: Tetragon Investor Call

Conference ID: 920147

Moderator: David Wishnow

A replay of the call will be available for 30 days by dialing +44 (0) 20 7031 4064 and +1 954 334 0342, conference ID 920147 and as an MP3 recording on the TFG website.

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| --- | --- |
| For further information, please contact: |  |
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|  |  |
| --- | --- |
| **Expected Upcoming Events** | **Date** |
| Q2 2012 Ex-Dividend Date | August 01, 2012 |
| Q2 2012 Dividend Record Date | August 03, 2012 |
| Quarterly Investor Call | August 08, 2012 |
| July 2012 Monthly Report | August 20, 2012 (approx) |
| Q2 2012 Dividend Payment Date | August 27, 2012 |









**CLO Equity Portfolio Details**

**As of June 30, 2012**



**CLO Equity Portfolio Details (continued)**

**As of June 30, 2012**



**CLO Equity Portfolio Details (continued)**

**As of June 30, 2012**



**Tetragon Financial Group Limited (TFG)**

**Portfolio Composition**

**Portfolio Held by Tetragon Financial Group Master Fund Limited**

**(unless otherwise stated)**

**As of June 30, 2012**



**An investment in TFG involves substantial risks. Please refer to the Company’s website at** [**www.tetragoninv.com**](http://www.tetragoninv.com) **for a description of the risks and uncertainties pertaining to an investment in TFG.**

This release does not contain or constitute an offer to sell or a solicitation of an offer to purchase securities in the United States or any other jurisdiction.  The securities of TFG have not been and will not be registered under the US Securities Act of 1933 (the "Securities Act"), as amended, and may not be offered or sold in the United States or to US persons unless they are registered under applicable law or exempt from registration.  TFG does not intend to register any portion of its securities in the United States or to conduct a public offer of securities in the United States.  In addition, TFG has not been and will not be registered under the US Investment Company Act of 1940, and investors will not be entitled to the benefits of such Act.  TFG is registered in the public register of the Netherlands Authority for the Financial Markets under Section 1:107 of the Financial Markets Supervision Act ("FMSA") as a collective investment scheme from a designated country. This release constitutes regulated information ("gereglementeerde informatie") within the meaning of Section 1:1 of the FMSA.

**Board of Directors**

Paddy Dear Reade Griffith Byron Knief\*

Rupert Dorey\* David Jeffreys\* Greville Ward\*

***\*Independent Director***

**Shareholder Information**

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Tetragon Financial Group Limited **Transfer Agent**

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Ogier

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Brunswick Group NYSE Euronext in Amsterdam

Andrew Garfield/Gill Ackers/Pip Green

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**Auditors** 1st Floor Dorey Court

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Channel Islands GYI 4AN

**Sub-Registrar and Transfer Agent**

Computershare

One Wall Street

New York, NY 10286

United States of America

**ENDNOTES**

1. (1) TFG invests substantially all its capital through a master fund, Tetragon Financial Group Master Fund Limited (“TFGMF”), in which it holds 100% of the issued shares. In this report, unless otherwise stated, we report on the consolidated business incorporating TFG and TFGMF. References to “we” are to Tetragon Financial Management LP, TFG’s investment manager. [↑](#endnote-ref-1)
2. () The LCM I, LCM II, LCM III, LCM IV, LCM V, LCM VI, LCM VIII, LCM IX, LCM X, and LCM XI CLOs are referred to as the “LCM Cash Flow CLOs.” The LCM VII CLO was a market value CLO previously managed by LCM, which was liquidated commencing in 2008, and is not included in the mentioned statistics. In addition, these statistics do not include the performance of certain transactions that were developed and previously managed by a third-party prior to being assigned to LCM, some of which continue to be managed by LCM. [↑](#endnote-ref-2)
3. () All of the LCM Cash Flow CLOs were current on their senior and subordinated management fees except for LCM I, which is significantly beyond its reinvestment period and has experienced material de-leveraging. [↑](#endnote-ref-3)
4. () The rolling 12-month dividend growth rate is calculated by dividing the sum of the dividends per share distributed or declared over the last 12 months by the dividends per share distributed or declared over the prior 12 months, less one. [↑](#endnote-ref-4)
5. ()The hurdle rate is reset each quarter using 3M USD LIBOR plus a spread of 2.647858% in accordance with TFG’s investment management agreement. Please see the TFG website, [www.tetragoninv.com](http://www.tetragoninv.com), for more details. [↑](#endnote-ref-5)
6. () Includes only look-through loan exposures through TFG’s CLO equity investments. [↑](#endnote-ref-6)
7. () Excludes CDO-squared and ABS CDO transactions which were written off in October 2007. TFG continues to hold the economic rights to three of these written-off transactions. [↑](#endnote-ref-7)
8. () Based on the most recent trustee reports available for both our U.S. and European CLO investments as of June 30, 2012. [↑](#endnote-ref-8)
9. () As of June 30, 2012, European CLOs represented approximately 10% of TFG’s CLO equity investment portfolio; approximately 76% of the fair value of TFG’s European CLOs and 60%, when measured as a percentage of the total number of European deals, were passing their junior-most O/C tests. [↑](#endnote-ref-9)
10. () As O/C tests are breached, CLO structures may divert excess interest cash flows away from the equity tranche holders, such as TFG, to pay down the CLO’s debt thereby curing the O/C breach via deleveraging. Accordingly, the affected investments ceased to generate cash flows to TFG or are expected to cease generating cash flows on the next applicable payment date. Once enough debt has been repaid to cure the O/C test breach, distributions of excess interest cash to equity holders may resume to the extent not precluded by the investments’ realized or unrealized losses. [↑](#endnote-ref-10)
11. () Morgan Stanley CLO Market Tracker, July 10, 2012; based on a sample of 481 U.S. CLO transactions. [↑](#endnote-ref-11)
12. () Weighted by the original USD cost of each investment. [↑](#endnote-ref-12)
13. () The calculation of TFG’s lagging 12-month corporate loan default rate does not include certain underlying investment collateral that was assigned a “Selective Default” rating by one or more of the applicable rating agencies. Such Selected Defaults are included the S&P/LCD lagging 12-month U.S. institutional loan default rate discussed above. Furthermore, TFG’s CLO equity and direct loan investment portfolio includes approximately 9.1% CLOs with primary exposure to European senior secured loans and such loans are included in the calculation of TFG’s corporate default rate. [↑](#endnote-ref-13)
14. () S&P/LCD News, “Leveraged loan default rate by number hits 11-month high in June,” July 2, 2012. [↑](#endnote-ref-14)
15. () S&P/LCD News, “(EUR) S&P ELLI: Default rate climbs to 5.5% in June, “July 9, 2012. The ELLI default rate is calculated by defining “default” as (a) an event of default, such as a D public rating, a D credit estimate, a missed interest or principal payment, or a bankruptcy filing; or (b) the beginning stages of formal restructuring, such as the start of negotiations between the company and lenders, or hiring of financial advisors. [↑](#endnote-ref-15)
16. () All of the LCM Cash Flow CLOs were current on their senior and subordinated management fees except for LCM I, which is significantly beyond its reinvestment period and has experienced material de-leveraging. [↑](#endnote-ref-16)
17. () S&P/LCD News, “Leveraged loan default rate by number hits 11-month high in June,” July 2, 2012. [↑](#endnote-ref-17)
18. () S&P/LCD News, “Leveraged loan default rate by number hits 11-month high in June,” July 2, 2012. [↑](#endnote-ref-18)
19. () S&P/LSTA Leveraged Lending Review 2Q 2012. [↑](#endnote-ref-19)
20. () S&P/LCD News, “(EUR) Topical: European loans generate €9.3B in 2Q12,” July 4, 2012. [↑](#endnote-ref-20)
21. () S&P/LCD Quarterly Review, Second Quarter 2012. [↑](#endnote-ref-21)
22. () S&P/LCD Quarterly Review, Second Quarter 2012. [↑](#endnote-ref-22)
23. () S&P/LCD Quarterly Review, Second Quarter 2012. [↑](#endnote-ref-23)
24. () S&P/LCD News, “(EUR) Topical: European loans generate €9.3B in 2Q12,” July 4, 2012. [↑](#endnote-ref-24)
25. () S&P/LCD News, “Leveraged loan volume contracts in 2Q as clearing yields push higher,” June 29, 2012. [↑](#endnote-ref-25)
26. () S&P/LCD Quarterly Review, Second Quarter 2012. [↑](#endnote-ref-26)
27. () Morgan Stanley CLO Market Tracker, July 10, 2012; based on a sample of 481 U.S. CLO transactions. [↑](#endnote-ref-27)
28. () Morgan Stanley CLO Market Tracker, April 4, 2012; based on a sample of 473 U.S. CLO transactions. [↑](#endnote-ref-28)
29. () Morgan Stanley CLO Market Tracker, July 10, 2012; based on a sample of 195 European CLO transactions. [↑](#endnote-ref-29)
30. () Morgan Stanley CLO Market Tracker, April 4, 2012; based on a sample of 195 European CLO transactions. [↑](#endnote-ref-30)
31. () Wells Fargo Structured Products Research – CLOs. “The CLO Salmagundi: New Capital Rules May Benefit CLO Issuers,” June 28, 2012. [↑](#endnote-ref-31)
32. () Wells Fargo Structured Products Research – CLOs. “The CLO Salmagundi: New Capital Rules May Benefit CLO Issuers,” June 28, 2012. Issuance volumes based on transactions priced, but not necessarily closed with the applicable time frame. [↑](#endnote-ref-32)
33. () For U.S. broadly syndicated CLOs, and in particular deals issued post-2010, the assumed reinvestment effective spread may receive an additional benefit from LIBOR floors, with such benefit dependant on future LIBOR rates. [↑](#endnote-ref-33)
34. () Citigroup, “Historical CLO Spreads”, June 1, 2012. [↑](#endnote-ref-34)
35. () Citigroup, “Historical CLO Spreads”, June 1, 2012. [↑](#endnote-ref-35)