June 2003

Contact	Phone
London	
Alexandra Sleator	44.20.7772.5377
Paris	
Jean-Luc Lepreux	33.1.53.30.10.30

Nexgen Financial Holdings Limited

Credit Strengths

The Nexgen group exhibits the following core credit strengths:

- A staff force with established financial and reinsurance knowledge as well as business connections
- A relatively low breakeven point and flexible structures which facilitate adjustments to client needs
- A high core capital position

Credit Challenges

However, we believe that the group faces the following main challenges going forward:

- Attracting and retaining staff of high intellectual caliber to preserve innovation and risk mitigation
- Achieving a stable flow of mandates with a more diversified range of customers
- Being able to gain access to various top level managers in a client organization
- Maintaining tight controls over and protections against the risk components of its transactions

Summary Opinion

Moody's evaluation of the creditworthiness of the Nexgen group does not factor in any shareholder support but does take into account the relatively close ties of the group with its two largest owners. We consider that the group adheres to sound principles of corporate governance, notably to oversee its relations with its two main shareholders. Given the types of risks being supported by Nexgen and the difficulty to precisely evaluate some of those risks' loss content, we view the maintenance over time of a very ample capital base by Nexgen as a key factor supporting the group's creditworthiness.

Moody's views Nexgen's positioning as a provider of tailor-made financial solutions as quite well differentiated relative to other players in that field. The group benefits from having managers and staff members combining an entrepreneurial spirit, well-established business connections and extensive capital markets expertise. The group's small structures afford it flexibility compared to larger organizations. Along similar lines, its business focus and clear independent status make Nexgen a worthwhile interlocutor for clients seeking a differentiated advice. Nexgen's business model is particularly reliant on each staff member's marketing and/or technical skills to offer added value.

Moody's has performed a general review of Nexgen's risk management tools, models and procedures. While these appear to conform to several recognized industry standards and can therefore be expected to perform well, Moody's cannot exclude the possibility for Nexgen to incur a large unexpected loss. However, Moody's does not consider Nexgen to be at risk of incurring an outsized loss. We view Nexgen's risk management attitude as relatively conservative as the group convincingly seeks to hedge but also to maintain other risk cushions against credit and market risks.

As a result of its current focus on equity-linked funding and risk transfer structures, Nexgen faces mainly equity, volatility and credit risks but is also exposed to interest rate, currency, counterparty and insurance risks. Given the multi-layered nature of Nexgen's financial concepts, the group is also exposed to correlation risk. The group uses a proprietary valuation and reporting system, complemented by the use of external risk management software tools. The group values its positions on a fair value basis whenever possible. Each risk type has been assigned a limit. Importantly in our view, the group is able to track the risk parameters of each individual deal. We view Nexgen's risk tolerance as relatively low. Limits are small in relation to equity. Average outstandings typically are well below limit levels. Residual open positions are of a manageable size.

Nexgen faces operational risk due to the degree of complexity of its transactions. The group's risk organization divides the conception, structuring and pricing of individual deals from the global management of the embedded risks after a transaction is executed. In addition, the risk monitoring function is separate from the team in charge of adjusting the hedges through market transactions. We view positively the involvement of the risk managers in the structuring phase to verify the group's capacity to monitor and minimize the resulting risks over time. We consider Nexgen's proprietary IT platform to be sophisticated and well adapted to its risk and business needs. Operational risk is mitigated by the use of standard concepts and tools. Duplication of hardware and software across locations should provide for business continuity in the event of a disaster.

Nexgen's revenue base is mainly deal-driven, dependent upon the number of client mandates which are signed. Over time, this element of vulnerability may be mitigated by the group's increasingly diversified business mix. We also note that Nexgen derives a more stable earnings stream from its arbitrage positions and the return on its two house portfolios. The group's expense base is mainly of a fixed nature. The breakeven point is relatively low. Given Nexgen's short life, we do not view the figures reported for either 2001 or 2002 as indicative of its recurring earnings power.

From a funding perspective, we view positively the group's practice of reviewing each transaction with respect to the identification of adequate funding sources. The group self-finances through securities repos to a large extent. While there exists some uncertainty as regards the stability of this type of funding, we view positively the fact that CDC Ixis is Nexgen's main provider and the group's efforts to diversify its funding sources. The remainder is funded by the group's own funds and, on a short-term basis, by uncommitted bank credit lines, the largest of which is extended by CDC Ixis. The largest transactions are funded with partner banks providing outside financing. Finally, credit mitigation agreements with clients usually contribute to the funding of the deals.

Niche Player Offering Customized Financial Solutions Relies on Creative Staff

Created in 2001 and trading under the name of Nexgen Financial Solutions, the Nexgen group is headed by Nexgen Financial Holdings Limited, an Irish holding company. Its main operating companies are Nexgen Capital Limited which undertakes the group's capital markets transactions, Nexgen Re Limited which engages in financial reinsurance and Nexgen Financial Solutions Limited which handles the structuring and the marketing of transactions. These companies are **regulated by the Irish Financial Services Regulatory Authority** (IFSRA). The group operates out of Dublin, Paris and Singapore catering to a clientele of **mainly corporate customers** but also insurance companies, banks and other financial services companies, as well as very high net-worth individuals located in **Europe and Asia**. Because Nexgen offers capital market-related financial solutions, the group's business in these two regions may differ significantly due to differences in the level of development of local capital markets and thus in customer needs.

The group's business model relies on the capacity of its staff members to **conceive and market innovative, tailor-made financing and risk transfer solutions**. As such, Nexgen is effectively selling intellectual innovation: its teams need to be able to constantly think ahead. Mitigating this pressure is the fact that there are relatively high barriers to entry in this field given the difficulty of combining the required capital markets expertise and the financial muscle to afford costly modeling and monitoring systems. Staff members bring know-how in structured finance, derivatives and reinsurance which the group leverages into multi-layered transactions mixing these different techniques. Owing to its small size[1], the group aims to **respond quickly to evolving capital markets and customer needs with a view to being "a-cyclical".**

The group's founders' main area of expertise lies in equity derivatives which Nexgen uses mostly to extend **alternative, equity-linked funding**. Typical equity derivative transactions will "monetize" – that is to say extract some of the cash component of either a company's treasury shares or a shareholder's stake. Corporate deals are generally larger – from $10 to $100 million (though better-quality European client deals may total several hundred millions) – than shareholder transactions – from $3 to $20 million.

In the current context of falling equity markets, the addition of put options also offers risk transfer possibilities. As a result, an increasing number of client transactions have either encompassed or targeted **credit and/or equity risk protection**. In addition, growing risk management concerns and/or balance sheet constraints today translate into solid demand for credit (re)structuring. That demand is likely to endure given the probable impact of IAS 39-related accounting changes with respect to consolidation. To this end, the group acquired in 2002 expertise in **financial reinsurance**, looking at credit and catastrophic risk. Here Nexgen also targets insurance companies which have been large sellers of credit protection in recent years.

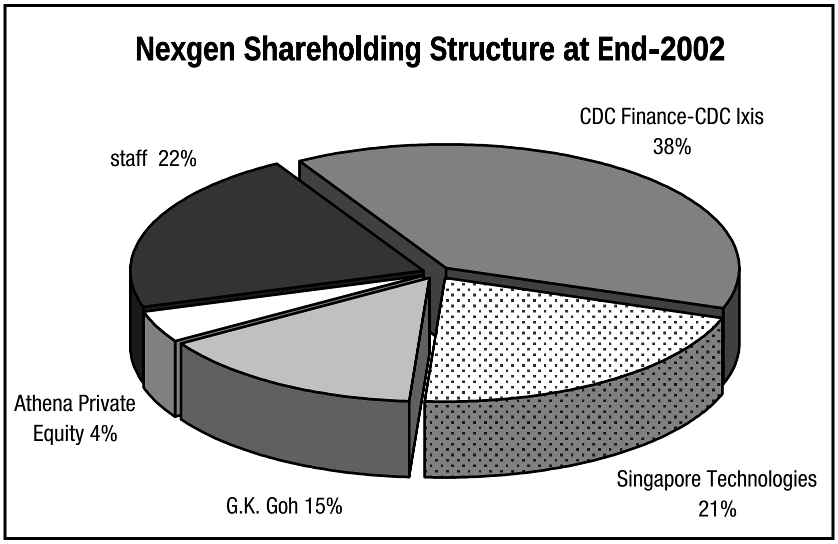
Nexgen also invests a limited proportion of its financial resources in **arbitrage and investment transactions for its own account** in order to raise its commercial and risk expertise. The group currently carries on its books a number of equity arbitrage positions, a portfolio of **Industry Losses Warranties** (ILW) and a CDO portfolio. Nexgen's ILW portfolio notably contains exposures to wind storms (e.g. Florida hurricanes), and to earthquakes in California and Japan. Leveraging off this portfolio, the group has devised a number of products offering protection against natural catastrophes but also against the combination of a natural catastrophe with an equity or credit-related adverse event. With respect to its **book of CDOs**, Nexgen seeks to take advantage of credit market inefficiencies and the diversification effect inherent to a combined portfolio. **The expertise which is gained through the management of the ILW and CDO portfolios** is also used as a "raw material" to structure client driven transactions.

Nexgen markets itself by leveraging off the business contacts of its staff members. Investment banks and shareholders also provide referrals. The group **eschews head-on competition with the investment banks** which are the other key providers of financial advice. While Nexgen is unable to offer potential clients the whole gamut of financial services, its positioning as an independent, quantitative think-tank makes it a worthwhile interlocutor and sometimes partner for investment firms. Given the complexity and broad strategic and financial implications of the transactions which Nexgen specializes in, we see as **an important marketing challenge the need for the group to secure access to various top level managers** within a given organization. In that respect, Nexgen's smaller size may put it at a competitive disadvantage relative to well-integrated investment banks with broad ties to Nexgen's target clients. This situation clearly puts a particular onus on Nexgen to actively and continually exploit its staff members' business connections as well as to team-up with financial partners such as advice-orientated investment banks.

1. *The number of Nexgen staff reached 47 employees at end-2002 coming from about half that number the year before.*

Largest Owners Appear Committed; Large Capital Position is a Positive Element

At end-2002, the shareholding structure of Nexgen was as follows. All shareholders are locked into a non-sale agreement expiring at the end of 2005. We view the largest shareholders as stable over time.



- **CDC Finance-CDC Ixis**[2] was created in 2000 and regroups all the open-market wholesale, investment banking and asset management activities of its parent Caisse des Dépôts et Consignations (CDC). Clearly segregated from CDC's public status and missions, CDC Ixis's businesses and subsidiaries compete freely with all other French and international institutions. Senior bankers newly-recruited by CDC Ixis refer some business to Nexgen: the two groups do not compete head-on as CDC Ixis is a provider of more mainstream financing. Exchange of know-how between the two groups is also ongoing. CDC Ixis also has the balance sheet size to accommodate some of the large deals which Nexgen cannot carry on its own books. Finally, CDC Ixis plays a key role as main financing partner for Nexgen as well as extending letters of credit to Nexgen Re to facilitate its reinsurance activities.
- **Singapore Technologies** is a government-owned technology-based multinational conglomerate. We understand that the group's shareholding in Nexgen is strategic rather than financial and represents that group's first major direct investment into Europe. In addition, the group's extensive business connections in Asia provide a platform for Nexgen's own marketing to corporate clients in that region.
- **G.K. Goh** is an Asian investment services group, operating out of Singapore. **Athena Private Equity** is a private equity fund controlled by several Italian financial institutions.
- **Employee-owned shares** are concentrated among those top managers who founded the group in 2001.
- Moody's considers that Nexgen adheres to sound principles of corporate governance, in particular:
- The presence of a ***Risk Controller and a deputy***, delegated by the two main owners, in Nexgen's offices, to supervise the risk management process and ensure compliance with prescribed risk limits;
- The ***Transaction Committee*** which reviews and approves all proposed principal transactions. This Committee examines the various risks arising from each individual operation, especially with respect to the acceptability and minimization possibilities for concentration and non-financial risks; and
- The ***Screening Committee***, newly set-up, and composed of other members than the Transaction Committee, which verifies the group's accurate knowledge of the clients with whom it engages in business. This exercise is particularly beneficial when customers are referred via intermediaries.

At end-2002, group equity stood at $193.8 million, up from $86.6 million the year before, mainly due to the entry of CDC Ixis as Nexgen's new largest shareholder on 11 December 2002[3]. Considering its total assets of $298.9 million and $127.5 million at end-2002 and end-2001 respectively, the group posted a **ratio of shareholders' equity to total assets of 64.8% in 2002** versus 67.9% in 2001. Capital is nearly evenly divided between the two main operating entities. Nexgen Capital is subject to regulatory capital requirements and, as such, reported a **Tier 1 ratio of 953%** at end-2002. We view positively the current shareholder agreement stipulating that no dividend will be paid before 1 December 2005.

2. *On 22 January 2003, Moody's confirmed the Aaa/Prime-1 ratings of CDC Ixis based on the guarantee provided by its parent, state-owned, Aaa-rated Caisse des Depôts et Consignations (CDC), as well as CDC Ixis's Aa1 non-guaranteed issuer rating. These rating actions were prompted by the decision of the European Commission to propose a gradual phasing out of the guarantee extended by CDC to some of CDC Ixis's obligations. At the end of March, the French authorities agreed that CDC would no longer be able to extend its guarantee from 24 January 2007. However, the status of those transactions currently guaranteed is not affected as these will remain covered by CDC's guarantee until they mature. Irrespective of the guarantee mechanism, Moody's views CDC's commitment toward its subsidiary as firm: CDC Ixis's non-guaranteed liabilities and commitments will continue to benefit from CDC's implicit support, a situation which is reflected by CDC Ixis's Aa1 issuer rating. However, any material change in CDC Ixis's ownership structure which could dilute CDC's expected support to its subsidiary would have negative implications for its non-guaranteed rating.*
3. *Athena Private Equity also entered Nexgen's capital on that date and made a further investment on 19 December.*

Relatively High Risk Profile Mitigated by Calibrated Attitude to Risk-Taking and Sophisticated Management and Hedging of Residual Credit and Market Positions

As a result of its current focus on equity-linked funding and risk transfer structures, Nexgen faces **mainly equity, volatility and credit risks** but also interest rate, currency, counterparty and insurance risks. Given the multi-layered nature of Nexgen's financial concepts, the group is also exposed to correlation risk.

In calibrating the size of its transactions, Nexgen considers the resulting hedging requirements relative to the liquidity of the underlying instrument/market(s) as well as resorts to averaging mechanisms to smooth the requirements linked to the initial set-up and final unwind. In some instances, regulatory considerations may also constrain the size of the transactions (e.g. when the regulatory value of the collateral received is below its economic value). Finally, Nexgen may need to look for support from its largest shareholders when a transaction implies that a client takes a large credit risk on Nexgen.

Nexgen distinguishes between "**hedgeable risks**" where the liquidity of the underlying market is sufficient and "**diversifiable risks**" where there is no underlying liquid market and risk minimization is possible only through statistical diversification. The group values its positions on a fair value basis whenever possible using a proprietary valuation and reporting system, complemented by external risk management software tools. Positions are valued daily in most instances, or weekly for less liquid instruments. In all cases, the valuation is measured against each type of risk incurred. Income attribution is done in relation to risk consumption. **Each risk type has been assigned a limit**. Hedgeable and reinsurance risk consumption is monitored using 99% VaR models – a credit VaR model is still under development. In addition, sensitivities for hedgeable risks and stress tests for diversifiable risks are closely supervised. **Importantly in our view, Nexgen can track the risk parameters of each individual deal**.

The **combined VaR limit for all hedgeable risks** – mainly equity, currency and interest rate – is set at **$10 million** modeled on a 10-day horizon. The overall VaR consumption remains on average well below the limit. With respect to equity risk, Nexgen seeks to be as little exposed as possible to either up or down movements in the underlying stock irrespective of whether it bought ("long) or sold ("short") the instrument or/and derivative thereof. In addition, the group seeks to mitigate its exposure to the volatility in the price of a given stock. In addition to the VaR limit used at the global level, the group closely monitors **additional indicators known as the "greeks"**: the delta, gamma and vega levels of its equity exposures.

The **delta** is the residual open position after a hedge has been put in place to substantially reduce a specific open position arising from a given trade. The group manages its residual open positions through "dynamic delta hedging", which involves adjusting (an) existing hedge(s) with a view to maintain a certain level of delta. Nexgen's risk management team is mandated to maintain a "delta neutral" position. At end-2002, the company reported a long equity delta of $18.4 million and a short equity delta of $678,000.

The **gamma** is the change in the residual open position (delta) arising from a change in the price of the underlying stock. A positive gamma means that, starting from a neutral residual open position, an increase in the price of the underlying security will result in a long residual position, while a drop will result in a short residual position. Both configurations produce unrealized trading gains, usually partially offset by the "time decay" effect on the derivative. At end-2002, the gamma was positive $599,000.

The last indicator is the **vega** which is the P&L impact of an upward parallel shift of 100 basis points in the annual volatility curve over a given period. Nexgen reported positive vegas across maturities. At end-2002, the group posted a total exposure of $281,000 for a 100 basis points move across volatilities.

Currency and interest rate risks are managed in pools aggregating the currency and interest rate risks resulting from each operation to benefit from mutualization. Regarding currency risk, Nexgen reported a short $122,000 open position in European currencies and a long $196,000 open position in Asian currencies at end-2002[4]. As for interest rate risk, Nexgen reported at end-2002 that a one basis point upward parallel shift in the interest rate of various currencies would result in an overall gain of $1,000. In contrast however, Nexgen stands to lose money on its CDO portfolio should interest rates pick up.

As regards the residual risks arising from the group's $28 million ILW portfolio of diversified natural risks, the delta arises from Nexgen having sold non-proportional protection and bought only partial protection on a similar range of risks. For this portfolio, risk mitigation is achieved through (i) diversification, (ii) multiple transactions whose individual deltas cancel each other out and (iii) offsetting transactions with opposite risk characteristics. The group reported **residual reinsurance risks of $23 million at end-2002** versus a VaR limit of $30 million modeled with a horizon extending to the latest maturity (on average, three to four years). The group recognizes the greater limitations inherent in modeling reinsurance risk and acknowledges the likelihood of fatter risk tails even with a 99% VaR model.

4. *All currency positions are measured against the US dollar which is Nexgen's currency of reference.*

Nexgen has a **policy to reserve against unexpected losses**. The reserve is calibrated depending on the remuneration of the capital which would be required in order to carry the position until maturity.

Credit risk arises mainly from the group's $15.8 million CDO portfolio but also from individual exposures as a result of counterparty client transactions. Its Asian operations in particular translate into some exposure to technology companies throughout non-Japan Asia. In addition, the group is also exposed – both directly and indirectly – to the Asian property sector. We do not note any material European risk concentrations. Nexgen also undertakes both single name and sector specific fundamental credit research on each stock in its books, also relying on external sources and credit default swap spread data.

Nexgen "marks-to-model" its CDO book and credit derivatives using credit default swap market spread data as well as correlation and interest rate parameters to quantify these risks. As such, it does not use historical default statistics. In the management's view, this ensures that Nexgen can efficiently hedge its credit exposures using credit derivatives or CDO tranches. Sensitivities to all model parameters – such as credit spreads and default correlations – are monitored and hedged when considered appropriate.

Credit risks in client transactions are mitigated by the presence of credit cushions arising from the taking of collateral, margin calls, and periodic or market price-triggered resets in contracts. In addition, specifically engineered protections, credit default swaps, guarantees and special purpose vehicle structures can be used to reduce credit risk further. The average rating of the CDO portfolio remains above investment grade despite some credit deterioration during 2002, In 2003, a period of further deterioration in the first months has since been followed by a recovery and a positive trading gain. The group reported a fair value of $22 million for that portfolio at end-2002 based on a "mark-to-model" valuation.

Nexgen faces **limited bank counterparty risk** as these are mostly at least A-rated institutions.

Nexgen faces **no commodity risk to-date** but is considering entering into oil-based transactions. The residual commodity risk position would be incorporated into the group's risk management framework.

Nexgen faces **operational risk** mainly stemming from the degree of complexity of its transactions. The group aims to break down and identify the various risk components bundled into each operation. The group's risk organization divides the conception, structuring and pricing of individual deals from the global management of the embedded risks after a transaction is executed. In addition, the risk monitoring function is separate from the team in charge of adjusting the hedges through market transactions. **We view positively the involvement of the risk managers in the structuring phase to verify the group's capacity to monitor and minimize the resulting risks over time**.

An important element in the group's risk management is the proprietary IT infrastructure which seamlessly links the transaction's pricing parameters and risk indicators thereby avoiding double inputting and affording multi-dimensional views of any given deal. **We consider Nexgen's proprietary IT platform to be sophisticated and well adapted to its risk and business needs**. Operational risk is mitigated by the use of standard, proven concepts and tools, in particular the adoption of a web-based user interface platform and the use of dedicated calculation machines operating in clusters. Duplication of hardware and software across locations should provide for business continuity in the event of a disaster.

Deal Dependency Translates into Inherent Revenue Volatility

At end-2002, Nexgen reported a net profit of $4.1 million, up from $154,000 the year before. Operating income reached $18.7 million at end-2002 coming from $4.6 million the year before. Nexgen earns a profit on the client-related financial operations it underwrites – whether executed in the capital markets or packaged as reinsurance transactions. The group does not charge its customers any fees. In addition, Nexgen earns a return on its arbitrage positions, its CDO and ILW portfolios, residual global interest rate and currency positions, and free capital. The financial accounts reflect the **gains and losses arising from marking to market or to model the positions in both on- and off balance sheet financial instruments**.

About two-thirds of the group's total disbursement consists of staff expenses. Administrative expenses are made up of T&E costs (24%), professional (mainly legal) fees (22%) and rental expenses (17%). Now that its structures are in place, management reckons that $15 million is a floor in terms of expenses and expects to be able to do a substantial amount of business on that basis. Given the average return on an average deal, we view this as a **relatively low breakeven point compared to other financial boutiques**. However, Nexgen, as a deal-driven outfit, does run the risk of having its teams "work for nothing", conceptualizing transactions which clients eventually fail to enter into. We therefore view positively the group's comparatively more recurring earnings coming from its arbitrage positions and CDO and ILW portfolios – although these investments could also lead to risk-related losses.

From a funding perspective, we view positively the group's practice of having the Transaction Committee **review each transaction with respect to the identification of adequate funding sources**. The group self-finances through securities repos to a large extent. While there exists some uncertainty as regards the stability of this type of funding, we view positively the fact that CDC Ixis is Nexgen's main provider and the group's efforts to diversify its funding sources. The remainder is funded by the group's own funds and, on a short-term basis, by uncommitted bank credit lines, the largest of which is extended by CDC Ixis. The largest transactions are funded with partner banks providing outside financing. Finally, credit mitigation agreements with clients usually contribute to the funding of the customer transactions.

Nexgen Financial Holdings Limited

USD (thousand)

Consolidated Profit and Loss account	31/12/2002	31/12/2001
Operating Income	**18,745**	**4,629**
Trading Income	8,061	2,536
client transactions	*5,264*	*2,536*
arbitrage positions	*1,709*	-
residual positions management	*(770)*	-
remuneration own funds	*1,858*	-
Collateralised debt obligations	6,490	-
Reinsurance technical income	4,708	153
Interest income	-	1,871
Other income	20	-
Transaction related professional fees	(534)	69
Operating expenses	**(13,903)**	**(4,197)**
Staff costs	7,907	1,680
wages and salaries	*6,321*	*1,359*
social welfare costs	*478*	*321*
pension costs	*750*	-
other staff costs	*358*	-
Auditors' remuneration	116	35
Depreciation	482	161
Other administrative expenses:	5,398	2,321
professional fees	*1,181*	*359*
directors emoluments	*619*	*903*
travel and subsistence	*1,281*	*273*
rent and office expenses	*912*	*243*
other administrative expenses	1,405	543
Profit before tax	**4,842**	**432**
Tax	(748)	(278)
Net profit	**4,094**	**154**

Nexgen Financial Holdings Limited

USD (thousand)

Consolidated Balance Sheet	31/12/2002	31/12/2001
ASSETS		
Cash	**3,172**	**938**
Deposits with financial institutions	**123,516**	**81,243**
unsecured	89,956	81,060
collateralised deposits	33,560	183
Trading securities	**123,629**	**40,297**
listed shares	69,234	40,297
bonds and convertibles listed and/or indexed to listed shares	54,395	-
Derivative financial instruments	**43,607**	**3,056**
financial institutions	24,525	-
other	19,082	3,056
Reinsurer's share of technical provision	**745**	**-**
Debtors	**3,112**	**679**
falling due within one year	1,836	679
falling due over one year	1,276	-
Tangible fixed assets	**1,162**	**1,248**
Total Assets	**298,943**	**127,461**
LIABILITIES		
Trading securities	**30,746**	**3,981**
shares	30,699	3,981
listed options	47	-
Derivative financial instruments	**45,670**	**9,335**
financial institutions	659	-
other	45,011	9,335
Loans from financial institutions	**22,575**	**25,587**
unsecured	-	17,522
collateralised loans	22,575	8,065
Reinsurance liabilities (provision for unearned premiums)	**1,208**	**-**
Creditors	**4,963**	**1,933**
accruals and deferred income	3,667	734
other creditors	548	921
deferred tax liability	436	-
corporate tax due	312	278
Total Liabilities	**105,162**	**40,836**
Equity shareholder's funds	**193,781**	**86,625**
preference shares	-	277
called-up share capital	1,861	589
share premium	187,632	85,635
retained earnings	4,248	154
other reserves	40	(30)
Total Liabilities and Equity	**298,943**	**127,461**

PAGE INTENTIONALLY LEFT BLANK

PAGE INTENTIONALLY LEFT BLANK

To order reprints of this report (100 copies minimum), please call 1.212.553.1658.
Report Number: SP0424

Author

Alexandra Sleator

Senior Production Associate

Phillip Stone