

END VIEW

From convertibles to correlation

Financial engineering group **Nexgen Financial Solutions** has never done things by halves. After three years in operation, the Dublin-incorporated firm can boast a thriving business that straddles the cutting edge in both the structured equity and structured credit markets, and which combines capital markets deal making with CDO asset management, correlation trading in equity and credit, and a sizeable structured credit investment for its own book.

Nexgen's main business is to provide equity derivative-based funding and risk transfer for corporate and financial institutions. The firm, which counts French investment bank **Ixis Corporate and Investment Bank** as its largest shareholder, provides equity-linked products to mainly corporate clients in Europe and Asia. Nexgen's Asian connection is cemented through stakes held by high-tech engineering firm **Singapore Technologies** (a subsidiary of **Temasek**), and by Singapore broker **GK Goh**. The firm has offices in Dublin, Paris, Milan and Singapore.

Equity-linked transactions over the past two years have included a \$100 million equivalent monetisation of shares in Korean utility **Kepeco**, via an equity swap; and swap deals relating to Italian investment company **Hopa's** stakes in **Telecom Italia** and **Olivetti**. Nexgen's equity-linked business results in a need for hedging using credit derivatives while, on the other side, the firm is offering clients credit derivatives in addition to equity linked product, as part of its risk management tool kit.

"Our core business is structured finance using equity derivatives," says **Ravi Viswanathan**, joint chief executive officer at Nexgen. "That results in counterparty risk and residual credit risk, so we are using credit derivatives as a hedging tool. We also provide risk management solutions using credit derivatives – for example, for corporates that want protection on their clients defaulting. More and more CFOs are taking an active view on those risks,

partly because accounting regimes are increasingly requiring companies to mark credit with market spreads."

The notional amount of equity derivative and credit derivative contracts on Nexgen's book totalled

Nexgen Financial Solutions

Perspective: Financial engineering boutique and structured credit investor

Preferred trade types: credit and equity correlation trades, CDO equity

Credit exposure: \$1.7 billion credit derivative notional; \$206 million bonds/convertibles

\$1.83 billion and \$1.67 billion, respectively, at June 30 2004. Over the first half of 2004, Nexgen's trading income from client-driven transactions totalled \$9.38 million. Nexgen has a team of roughly 25 structurers as well as three traders

In addition to applying credit derivatives to corporate risk management, the other, and more important, part of Nexgen's credit business is CDO management and investment. The firm's involvement in the CDO market was initially as an investor. "We entered the structured credit market two years ago with an investor view," says Viswanathan. "We thought there

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was a good opportunity to leverage part of our capital, by selling protection at the equity level. Nine months later we started to hedge that exposure – not by selling back the equity, because we felt there was still a lot of juice, but by buying protection on mezzanine pieces." CDO holdings include an investment in a synthetic investment-grade corporate deal, **Biltmore 2002-1**.

Nexgen has gone on to manage a variety of mainly single-tranche

portfolio credit swaps, including a single-tranche CDO squared that closed last month.

"We try to do a few big transactions a year, and mainly single tranches," says Viswanathan. "Our structured credit business tends to focus more on corporates and financial institutions where it is for their own books, so that helps differentiate us from the big investment banks, where the focus is more on the general investor community."

Nexgen manages the delta-hedging of its structured credit and equity derivative businesses on the same book. "Over the last year we have tried to use a macro hedge," he says. "If you are long vega (long volatility on equity derivatives) it makes sense to be long credit as well, and if you are both you can have a macro hedge. We are seeing this more and more – dealers combining their equity derivative and credit correlation in the one book to take advantage of this kind of efficiency."

According to Viswanathan, Nexgen is increasingly coordinating its CDO activity with parent company **Ixis**, a bank that has raised its profile significantly in the CDO field over the past year and which owns US credit specialist **Reich & Tang Asset Management**.

One trend that Viswanathan expects over the next six months is a growing emphasis by correlation desks on new hedging techniques. "We will see more and more emphasis from correlation desks on how to hedge correlation," he says. "As long as spreads are so low, you are going to be less able to actively market first-to-defaults and equity leverage and so on. Rather, desks will concentrate more on strategies where they are demonstrating ways to earn money in circumstances where spreads move. So structuring will be around spread movement rather than default."

Viswanathan also thinks that options on leveraged tranches of credit derivative indices will be a growth area in 2005. **EUAN HAGGER**