

## GENERATOR NZ NO. 1 TRUST

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Aug. 20, 2003.

**NZ\$128.849 million single-name repackaged bonds**      A-

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### PROGRAM SUMMARY

<i>Issue date:</i>	Aug. 20, 2003.
<i>Scheduled maturity date:</i>	Aug. 20, 2008.
<i>Structure type:</i>	Single-name repackaged bonds.
<i>Issuer:</i>	Generator NZ No. 1 Trust.
<i>Authorized investments:</i>	NZ\$128.849 million fixed-rate subordinated class C portfolio credit-linked notes issued by KIWI 1 (CDO) Ltd. (KIWI), a company incorporated under the laws of Jersey.
<i>Trustee:</i>	Generator Bonds Ltd.
<i>Security trustee:</i>	New Zealand Permanent Trustees Ltd.
<i>Supporting rating:</i>	KIWI class C portfolio credit-linked notes (A-).

### RATIONALE

The 'A-' rating assigned to the NZ\$128.849 million bonds issued by Generator NZ No. 1 Trust (Generator) indicates that Generator has a strong capacity to pay interest due on the initial face value of the bonds on each quarterly payment date, and to repay principal in full to investors on the scheduled maturity date, in accordance with the terms and conditions of the bonds. The proceeds of the Generator bonds have been invested in the class C credit-linked notes (CLNs) issued by KIWI 1 (CDO) Ltd. (KIWI). As such, the rating on the Generator bonds reflects the rating on the KIWI notes.

The KIWI notes are debt securities whose payment of interest and principal are linked, through a credit default swap, to the credit performance of 100 companies in the NZ\$6.442 billion reference portfolio during the five-year term of the notes. The first loss amount of NZ\$284.1 million is borne by the credit default swap counterparty. For the purpose of assessing the impact to payments on the bonds, poor credit performance is limited to significant company defaults (as defined in Company Defaults).

It is important to note that KIWI has exposure to, but does not own, the reference portfolio assets. The assets of KIWI, in respect of the notes, are limited to the note proceeds deposited in bank accounts with appropriately rated banks, and the right to receive the premium from the swap counterparty under the credit default swap.

### What Does the 'A-' Rating on the Generator Bonds Reflect?

The rating on the Generator bonds reflects the rating on the KIWI notes, which in turn reflects:

- Standard & Poor's assessment of the credit risk of the reference portfolio (and specifically, it addresses the probability of losses in the reference portfolio exceeding the NZ\$284.1 million first loss amount borne by the credit default swap counterparty); and

- The prepayment of the entire swap premium for the term of the transaction by the credit default swap counterparty at closing (as such, the rating on the KIWI notes and, correspondingly, the Generator bonds, is not dependent on the rating on the credit default swap counterparty).

Macquarie Bank Ltd. (MBL, A/Stable/A-1) has provided an interest rate swap to KIWI in relation to the class C notes, converting the floating-rate interest allocated to that class into fixed-rate interest. Investors should note that the KIWI notes and, correspondingly, the Generator bonds, will revert to a floating-rate interest if MBL defaults in its payment obligations under the interest rate swap, or fails to replace itself within a certain period of time if its short-term rating is lowered below 'A-1'. MBL is not entitled to any swap break costs under these circumstances. As such, the rating on the KIWI notes and, correspondingly, the Generator bonds, is not dependent on the performance or the rating on MBL.

The rating on the Generator bonds throughout its term will reflect the rating on the KIWI notes, which in turn will reflect Standard & Poor's assessment of the credit quality of the reference portfolio after taking into account the sufficiency of the remaining first loss amount.

#### **Events That May Change the Rating on the Generator Bonds**

A number of events can lead to the revision of the initial rating on the KIWI notes and, correspondingly, the Generator bonds. Such rating revisions are not necessarily associated with any alterations in the quarterly payment of interest or the repayment of principal of the notes. These events include:

- Changes to the credit ratings on the companies in the reference portfolio, without the occurrence of a significant company default, which may result in the required first loss amount at that time being higher than the actual first loss amount provided at the initial rating date;
- Occurrence of company defaults in the reference portfolio, which may result in the remaining first loss amount falling below that required to affirm the rating on the KIWI notes at that time; and
- Changes to the credit ratings on the banks, where the note proceeds and prepaid swap premiums are deposited, and the banks are not replaced by other appropriately rated banks.

#### **Events That May Cause the Generator Bonds to Redeem Early**

A number of events can lead to the KIWI notes and, correspondingly, the Generator bonds, redeeming before their scheduled maturity. These events include:

- A relevant tax event occurs in relation to KIWI and the majority of noteholders of any class of notes issued by KIWI exercise their option to redeem early;
- A relevant tax event occurs in relation to the KIWI credit default swap; and
- An early termination (other than a tax event) occurs in relation to the KIWI credit default swap.

Should any of these events occur, the KIWI noteholders and, correspondingly, the Generator bondholders, will be exposed to break costs on the KIWI credit default and interest rate swap, and may receive less than the principal outstanding on the notes/bonds. Standard & Poor's rating does not address the first two early redemption events, which are akin to a change in law. The third early redemption event is consistent with the rating on the notes, as the early termination of the credit default swap is restricted to events such as failure to pay, bankruptcy, merger without assumption, illegality, or if the notes become due and payable before the scheduled maturity date and/or due to enforcement of the security charge.

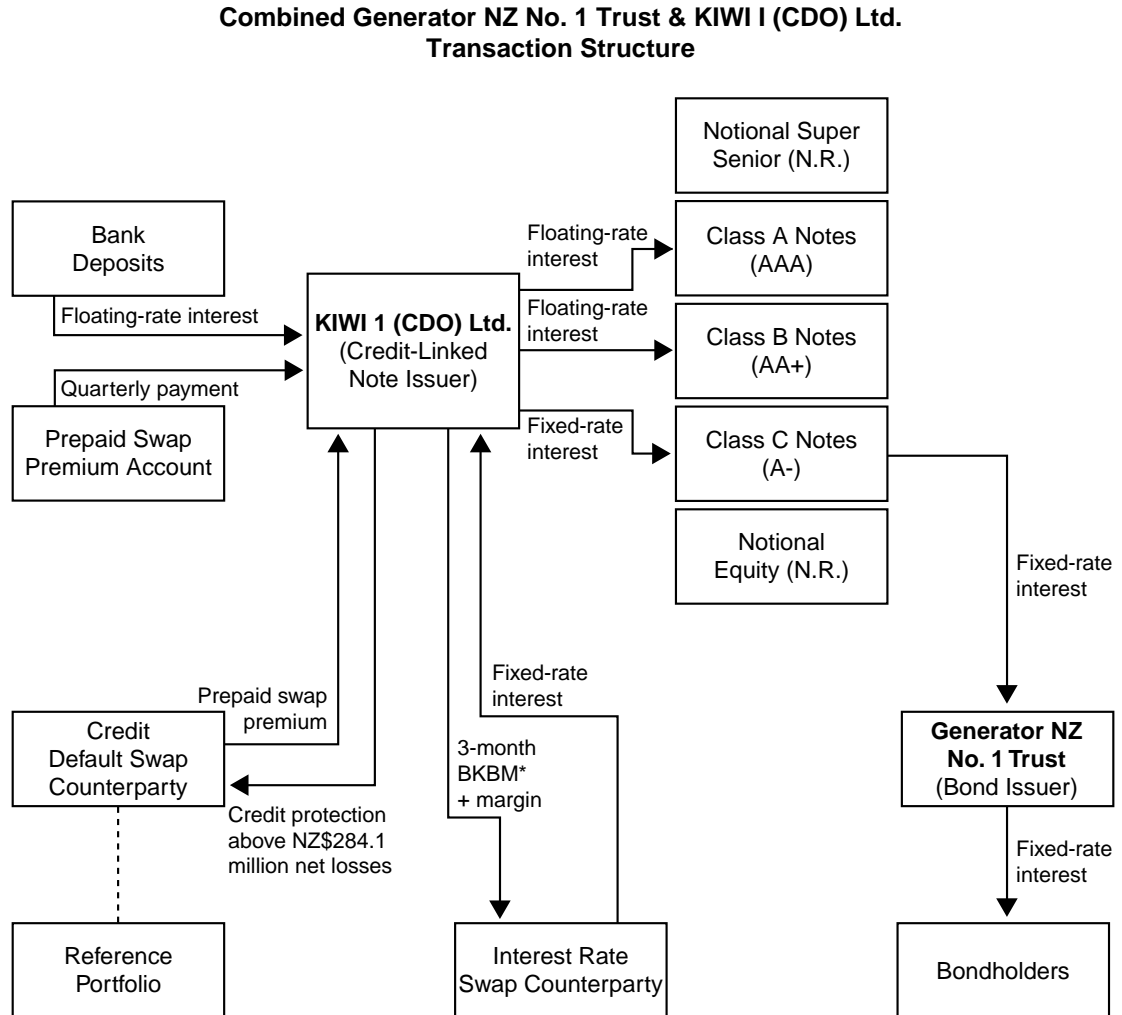
#### **Events That May Cause the Generator Bonds to Repay Late**

The scheduled maturity date of the KIWI notes and, correspondingly, the Generator bonds, is five years from the issue date but can be deferred if there are company defaults in the reference portfolio just prior to the scheduled maturity date. This is because the process to

calculate losses following a company default is not immediate. Standard & Poor's rating addresses the likelihood of full repayment of principal by the deferred maturity date.

## TRANSACTION STRUCTURE

The following diagram illustrates the transaction structure.



\*BKBM—New Zealand bank bills mid rate.  
N.R.—Not rated.

### How Will Generator Pay Interest and Repay Principal to Investors?

The Generator bondholders are buying New Zealand dollar fixed-rate bonds that are repackaged from the New Zealand dollar fixed-rate class C CLNs issued by KIWI. The principal and interest payments of the Generator bonds will broadly mirror the principal and interest payments of the KIWI notes. Generator should earn sufficient income from the interest on the KIWI notes to pay interest on the bonds and other expenses of Generator.

An interest rate swap is provided by MBL to KIWI in relation to the class C notes, converting the floating-rate interest allocated to that class into fixed-rate interest. If the interest rate swap counterparty defaults in its payment obligations or fails to replace itself if its short-term rating is lowered below 'A-1', the KIWI notes and, correspondingly, the Generator bonds, will revert from fixed-rate to floating-rate interest.

Under the credit default swap, KIWI is entitled to receive from the swap counterparty a quarterly premium in return for KIWI (and ultimately, the Generator bondholders) taking an exposure to the credit risk on the companies in the reference portfolio. The proceeds of the KIWI notes will

be held in bank deposits. KIWI should earn sufficient income from interest on the bank deposits and the premium on the credit default swap to pay interest due on the notes and other expenses of KIWI. As the credit default swap counterparty is not rated, the entire premium for the term of the transaction will be prepaid at closing.

If there are defaults and subsequent losses on the companies in the KIWI reference portfolio, and those losses exceed the NZ\$284.1 million first loss amount borne by the credit default swap counterparty, an amount equivalent to the excess loss amount will be withdrawn from the KIWI bank deposits and paid to the credit default swap counterparty. Payment of this amount by KIWI results in a reduction of the principal balance of the KIWI notes and, correspondingly, a reduction of the principal balance of the Generator bonds. As a consequence, the KIWI noteholders will receive reduced quarterly interest payments (calculated on the reduced note principal balance) and a reduced repayment of principal at maturity. Correspondingly, the Generator bondholders will receive reduced quarterly interest payments and a reduced repayment of principal on maturity.

### **Company Defaults**

In relation to the KIWI notes, a company default may arise among companies in the reference portfolio. A company default occurs only if a company:

- Becomes bankrupt or insolvent;
- Fails to pay at least US\$1 million or equivalent of its debt obligations; or
- Has at least US\$10 million or equivalent of its debt obligations adversely restructured due to a deterioration in its creditworthiness or financial condition.

### **Calculation of Loss Amount Upon a Company Default**

In relation to the KIWI notes, if a company in the reference portfolio defaults, a senior unsecured bond or loan (together, debt) obligation of that company selected by the calculation agent (The Bank of Nova Scotia) will be used to determine the extent to which the market value of that debt obligation has fallen below its principal amount. The percentage market value loss of the company's debt obligation is used by the calculation agent to calculate a loss amount by applying the percentage market value decline to the New Zealand dollar weighting of the company in the reference portfolio (i.e. NZ\$64.42 million).

### **First Loss Amount**

In relation to the KIWI notes, the credit default swap counterparty has agreed to absorb any loss amounts arising from company defaults up to an aggregate limit of NZ\$284.1 million. This amount is referred to as the first loss amount, and represents 4.41% of the aggregate value of the reference portfolio. This amount is in excess of the 4.09% required by Standard & Poor's to achieve the 'A-' rating on the notes (see Standard & Poor's Credit Evaluation). The first loss amount means that if companies in the reference portfolio default and the aggregate net losses calculated on those company defaults are less than or equal to NZ\$284.1 million, then the swap counterparty will not be entitled to make a claim on KIWI for loss. As such, KIWI noteholders will not be exposed to loss amounts on company defaults within the reference portfolio to this limit. If, however, during the term of the bonds the aggregate net losses on company defaults in the reference portfolio exceeds NZ\$284.1 million, then the credit default swap counterparty is entitled to receive payment equivalent to the amount of those net losses in excess of the first loss amount. The maximum amount payable to the swap counterparty under the credit default swap cannot exceed the initial note issue amount held in bank deposits.

## **REFERENCE PORTFOLIO CHARACTERISTICS**

The KIWI noteholders and, correspondingly, the Generator bondholders, are exposed to the credit performance of the senior unsecured debt obligations (senior debt) of companies in the reference portfolio, subject to the NZ\$284.1 million first loss amount borne by the credit default swap counterparty. The size of the reference portfolio is much larger than the face value of all classes of notes issued by KIWI. This risk is addressed in Standard & Poor's

rating in so much as the first loss amount required to achieve the rating on the KIWI notes has been calculated on the size of the reference portfolio, not on the size of the notes.

The summary portfolio statistics of the companies in the reference portfolio as at Aug. 20, 2003, are shown in tables 1, 2, and 3 of this report. The companies are diversified by industry (see table 1) and by geography (see table 2), and all companies are rated 'BBB-' or higher (investment grade) by Standard & Poor's (see table 3). There will be no changes to the companies after the closing date except in limited circumstances, for example, to the extent the ownership of a company changes, such as in the case of demergers or takeovers.

The obligations that will be used to calculate the loss percentage if a company in the reference portfolio defaults will be the senior debt of the companies. Senior debt ranks ahead of subordinated debt and equity, should a company be liquidated. The specific debt obligations meeting standard selection criteria are defined at the outset of the transaction in the credit default swap.

**Table 1 – Portfolio Distribution By Industry**

<b>Industry name</b>	<b>No. of companies</b>	<b>Exposure (%)</b>
Electronics/electrical	8	8
Financial intermediaries	8	8
Telecommunications	8	8
Insurance	7	7
Utilities	7	7
Automotive	6	6
Radio & television	5	5
Aerospace & defense	4	4
Publishing	4	4
Retailers (except food & drugs)	4	4
Air transport	3	3
Beverage & tobacco	3	3
Building & development	3	3
Business equipment & services	3	3
Chemicals & plastics	3	3
Food/drug retailers	3	3
Brokers, dealers & investment houses	2	2
Conglomerates	2	2
Containers & glass products	2	2
Food products	2	2
Industrial equipment	2	2
Lodging & casinos	2	2
Nonferrous metals/minerals	2	2
Cable & satellite television	1	1
Equipment leasing	1	1
Food service	1	1
Forest products	1	1
Leisure goods/activities/services	1	1
Steel	1	1
Surface transport	1	1
<b>Total</b>	<b>100</b>	<b>100</b>

**Table 2 – Portfolio Distribution by Country**

<b>Country</b>	<b>No. of companies</b>	<b>Exposure (%)</b>
United States	45	45
United Kingdom	14	14
Germany	12	12
France	8	8
Australia	6	6
Netherlands	5	5
Canada	3	3
Switzerland	2	2
Finland	1	1
Hong Kong	1	1
Italy	1	1
New Zealand	1	1
Sweden	1	1
<b>Total</b>	<b>100</b>	<b>100</b>

**Table 3 – Portfolio Distribution by Ratings**

<b>Rating</b>	<b>No. of companies</b>	<b>Exposure (%)</b>
AAA	3	3
AA	1	1
AA-	4	4
A+	7	7
A	12	12
A-	17	17
BBB+	23	23
BBB	21	21
BBB-	12	12
<b>Total</b>	<b>100</b>	<b>100</b>

**Ratings Outlook and CreditWatch**

Standard & Poor's credit ratings are forward looking and are designed to remain stable over the course of normal business cycles. When circumstances warrant – such as unforeseen changes in business position, finances, or economic conditions – Standard & Poor's will place a borrower on CreditWatch, a signal to the market that the rating is subject to possible change within the near term. The review process is the same as that of a new credit rating, and a rating will be removed from CreditWatch once a decision is made to raise, lower, or affirm it. A CreditWatch listing does not mean a rating change is inevitable. Rating changes can also occur without the borrower appearing on CreditWatch. Within the portfolio, a total of eight companies have ratings on CreditWatch Negative. Of these, two have a rating of 'A', two of 'A-', two of 'BBB+', and two of 'BBB'. One company is on CreditWatch Positive and one is on CreditWatch Developing.

Standard & Poor's ratings outlooks (positive, negative, or stable) are assigned to all long-term credit ratings, except for ratings on structured notes, such as the Generator bonds. Outlooks are distinguished from CreditWatch listings by a longer timeframe – one to three years – and take into account trends or risks with a less direct impact on credit quality. Within the portfolio, a total of 44 companies have a negative outlook and 46 have a stable outlook. No company has a positive outlook.

## STANDARD & POOR'S CREDIT EVALUATION

The primary credit risk to the KIWI noteholders, and hence the Generator bondholders, is linked to the reference portfolio, and is a function of the probability of default of the companies in the reference portfolio and the recovery value of the defaulted companies. The credit evaluation therefore involves:

- Determining the probability of default of the companies in the reference portfolio using Standard & Poor's CDO Evaluator (see explanation below);
- Estimating the recovery value of the companies in the reference portfolio; and
- Determining the required first loss amount, taking into account the probability of default, the expected recovery value, and the notional amount of the reference portfolio.

### Determining Probability of Default

In relation to the KIWI notes, Standard & Poor's has estimated the probability of default (stressed default rate) of the companies in the reference portfolio over the five-year term of the notes by comparing the rating on each company in the portfolio with a set of default probability assumptions based on Standard & Poor's report, *'2002 Ratings Performance: Default, Transition, Recovery, and Spreads'* (see Related Research). The proprietary tool that Standard & Poor's uses to undertake this analysis is called CDO Evaluator. A sample of default probability assumptions used in the CDO Evaluator is set out in table 4.

**Table 4 – Sample of Default Probability Assumptions for Corporates\***

AAA	AA	A	BBB	BB	B	CCC
0.284%	0.757%	1.111%	2.500%	11.255%	23.488%	41.083%

\*Maturity term of five years.

The issuer credit rating on the reference entity is used in the CDO Evaluator regardless of the ranking of the obligations. However, the recovery value assumptions will vary depending on the ranking of the obligations. Where the rating on a reference entity is on CreditWatch Negative, the rating used in the CDO Evaluator will be adjusted downwards by one notch. Conversely, if the rating on the reference entity is on CreditWatch Positive, the rating used in the CDO Evaluator will be adjusted upwards by one notch.

For the KIWI reference portfolio, Standard & Poor's estimated stressed default rate is 5.94% at the 'A-' rating level. The stressed default rate is adjusted by applying recovery value assumptions to derive the net default rate and the required first loss amount, as described below.

Investors should note that the *'2002 Ratings Performance: Default, Transition, Recovery, and Spreads'* report (see Related Research) contains data on the performance of all Standard & Poor's ratings on companies over time, including the default experience of companies at each rating category, and rating changes on companies over time for each rating category. However, investors should note also that the reference portfolio is a very small subset of the total universe of ratings Standard & Poor's assigns to companies around the world. The reference portfolio may not perform in the same way as the total ratings portfolio in Standard & Poor's corporate default study.

### Recovery Value

Recovery value assumptions used by Standard & Poor's depend on a combination of factors, including market liquidity/recovery data, bankruptcy laws, ranking of obligations, type of obligations, valuation method, and valuation date.

Standard & Poor's has assumed an average recovery value for the KIWI reference portfolio of 31.14%. This implies an estimated average loss of 68.86% for each company default.

### First Loss Amount Required to Support Rating on Notes

Once the KIWI reference portfolio's stressed default rate and recovery value are determined, it is then possible to calculate the net loss that the reference portfolio may suffer in a stressed environment commensurate with the credit rating sought. The estimated net loss rate, and therefore the required first loss amount, is calculated as follows:

$$\begin{aligned}\text{Estimated net loss rate} &= \text{Stressed default rate} \times (100\% - \text{recovery value}) \\ &= 5.94\% \times (100\% - 31.14\%) \\ &= 4.09\%\end{aligned}$$

$$\begin{aligned}\text{Required first loss amount} &= \text{Notional amount of reference portfolio} \times \text{Net loss rate} \\ &= \text{NZ\$6.442 billion} \times 4.09\% \\ &= \text{NZ\$263.5 million}\end{aligned}$$

To achieve the 'A-' rating on the KIWI notes, this first loss amount must be available to absorb losses on the reference portfolio before any losses can be allocated to noteholders. The actual first loss amount borne by the credit default swap counterparty in this transaction is NZ\$284.1 million, which represents a buffer of NZ\$20.6 million (0.32% of the reference portfolio amount) over the NZ\$263.5 million first loss amount required by Standard & Poor's to support the 'A-' rating on the KIWI notes.

### Analysis of How Many Company Defaults the First Loss Amount Provided Can Withstand

Table 5 illustrates the number of companies in the reference portfolio that can default before the face value of the KIWI notes and, correspondingly, the Generator bonds, will be reduced (second column), as well as the number of company defaults that would cause the face value of the KIWI notes and, correspondingly, the Generator bonds, to be reduced to zero (third column). The impact of these company defaults will be determined by the resulting loss percentage that is calculated on each company default (first column). The first column represents a range of hypothetical loss percentages that have been applied to calculate the number of company defaults in the second and third columns. For example, if the average loss percentage for each company in the reference portfolio that defaults is 50% (the third row), the face value of the notes/bonds will be able to withstand eight company defaults without being reduced (second column). In the same example, the face value of the notes/bonds would be reduced to zero if 11 companies defaulted.

**Table 5 – Number of Company Defaults the First Loss Amount Can Withstand\***

Hypothetical avg. loss for each defaulting company (%)	No. of companies that can default with no reduction to the face value of notes	No. of companies that can default before the face value of notes is reduced to zero
0.0	100	N/A
25.0	17	26
50.0	8	13
69.1¶	6	10
75.0	5	9
100.0	4	7

\*Assuming no succession event. ¶Standard & Poor's estimated average loss. N/A-Not applicable.

### Rating Surveillance

As long as the KIWI notes remain outstanding, the remaining actual first loss amount needs to exceed Standard & Poor's estimation of the required first loss amount at a given rating level to maintain that rating on the KIWI notes. Standard & Poor's will recalculate the required first loss amount on a regular basis to allow for the shortening of the term to maturity, any changes of ratings in the reference portfolio, and any company defaults and loss amounts that may arise in the reference portfolio. If the actual remaining first loss amount is less than

Standard & Poor's estimation of the required first loss amount, the rating on the KIWI notes and, correspondingly, the Generator bonds, will be lowered. Equally, if the actual remaining first loss amount is greater than Standard & Poor's estimation of the required first loss amount, the rating on the KIWI notes and, correspondingly, the Generator bonds, may be raised.

#### **RELATED RESEARCH**

- Presale: KIWI 1 (CDO) Ltd.
- Repackaged Securities – Analysing Both Credit and Noncredit Risks, published March 24, 2002.
- Synthetic Collateralised Debt Obligations and Credit-Linked Notes – A Rating Perspective, published Sept. 27, 2001.
- Rating Transitions 2002: Global CDO & Credit Default Swap Rating Performance, published March 14, 2003.
- 2002 Ratings Performance: Default, Transition, Recovery, and Spreads, published February 2003.
- Corporate Credit Ratings – A Guide, published December 2001.

The above articles are available on RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). They can also be found on Standard & Poor's Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Under Credit Ratings select News & Analysis. Then find the article under Commentary & News.

#### **WHAT IS A CREDIT RATING?**

A Standard & Poor's credit rating is a current assessment of an issuer's ability to make full and timely payments on its financial obligations. An 'A-' rating means that an issuer has a strong capacity to meet financial commitments.

- Long-term ratings range from Standard & Poor's highest category 'AAA', to the lowest, 'D' category.
- Ratings in the 'AAA', 'AA', 'AA-', and 'BBB' categories are regarded as investment grade.
- Ratings in the 'BB', 'B', 'CCC', 'CC', and 'C' categories are regarded as having significant speculative characteristics.
- A rating of 'D' denotes a payment default on financial commitments.

#### **STANDARD & POOR'S COMPANY RATINGS**

The ratings for each company in the reference portfolio are available on RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). They are also publicly available on Standard & Poor's Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Under Credit Ratings select Credit Ratings Lists. Then under Filter by Name, enter the company's name.

*A rating is not a recommendation to purchase, sell or hold a security, in as much as it does not comment as to the market price or suitability for a particular investor. A debt rating is a current assessment of the ability of a borrower to repay principal and interest with respect to a specific long or short-term obligation in a timely manner. Ratings may be changed, suspended or withdrawn as a result of changes in, or unavailability of, information or other circumstances.*

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