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Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.

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Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.

Major Rating Factors

Issuer Credit Rating
AAA/Negative/A-1+

Strengths:

- Almost certain government support in the event of financial distress.
- The state's maintenance obligation and guarantee of FMO's financial commitments.
- Historically strong financial profile.

Weaknesses:

- An income stream characterized by significant volatility.
- High-risk lending profile.

Rationale

The ratings on the development finance institution, Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO) are based on an equalization with the ratings on the State of The Netherlands (unsolicited ratings, AAA/Negative/A-1+), reflecting Standard & Poor's Ratings Services' opinion that there is an "almost certain" likelihood that the Dutch government would provide timely and sufficient extraordinary support to FMO in an event of financial distress.

In accordance with our criteria for government-related entities (GREs), our rating approach factors in our view of FMO's:

- "Critical" role as the key government vehicle for promoting private-sector growth in developing countries, an important public policy goal in The Netherlands; and
- "Integral" link between the government and the GRE. The ratings reflect the 51% government ownership and the strong sovereign support for the company, based on the operating maintenance obligation and the solvency commitment, as well as a track record of support.

Sovereign support was formally codified in the 1998 agreement between FMO and the state. Under Article 8 of the agreement, the state is legally required to enable FMO to meet its obligations on time. The duration of the agreement is indefinite and its termination requires 12 years' notice by either party. The Netherlands' long-term commitment to, and support of, FMO is also demonstrated by the sovereign's obligation in most circumstances to safeguard the company's solvency (Article 7 of the agreement).

FMO supports businesses and financial institutions in developing countries with capital and skills. It does so by arranging loans (€2.6 billion in 2010), equity investments (€690 million), guarantees (€83 million), and other investment promotion activities. In addition, it manages several development funds on behalf of, and at the risk of, the Dutch government: these account for about one-fifth of the total portfolio.

In 2010, FMO's activity levels started to increase, which is reflected in a 13% increase in new commitments from

2009 levels. High provisioning in 2008 and 2009 and faster-than-anticipated recoveries in related transactions kept 2010 provisions at historically low levels. Subsequently, net profit more than doubled in 2010 to €126 million, from 2009, the second highest level in the past decade. Net interest income of €133 million in 2010 was also at historically high levels as was income on equity investments over 2009 levels, which almost doubled from 2009 levels.

We anticipate that FMO's activity levels will remain among the highest of similar institutions, partly as a result of increased risk aversion among commercial banks, but also because of FMO's ability to fulfill its strong government mandate. However, as in 2008 and 2009, we do expect the current adverse market conditions to have an impact on FMO's operations. Possible channels for disruption are through those income streams that have been most volatile historically; FMO's income from equity investments, which includes revenues from equity exits and dividends, appears most likely to decline in our view.

Because FMO only pays out a small share of profits as dividends, shareholder equity remained at 2009 levels of 35.2% of total assets. Given the nature of its business and the high level of equity and mezzanine financing, we view FMO's financial results as fairly volatile. However, based on FMO's track record of managing emerging market risks, we expect that the company will remain profitable in the future.

Outlook

The negative outlook on FMO mirrors that on The Netherlands and also reflects our expectation that the 1998 agreement with the Dutch state will remain in force for the foreseeable future.

Given that FMO already has a very strong capital base relative to its business, we do not expect the state to make further capital contributions. We consider FMO's prospects as a majority state-owned company with a strong public mandate and continued support from the state to be secure.

Extraordinary Government Support: Almost Certain In Light Of Public Policy Role

We view the role of FMO as "critical" to meeting the official policy objectives of the State of The Netherlands. Furthermore, we view the link between the government and FMO as "integral". This latter view is supported by a track record of credit support to FMO, as well as by the state's support for FMO's financial obligations and its commitment to continue funding FMO if necessary.

FMO was established in 1970 by the state, several Dutch companies, and trade unions as a joint-stock company under the "Law of May 1, 1970, on Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V." Under FMO's Articles of Association, the company is mandated to promote the economic and social progress of developing countries by funding private sector investments--primarily through long-term loans and equity investments--in those countries in line with the Dutch government's policy goals on development cooperation. FMO also provides guarantees for third-party investments in developing economies and plays an active role in trade financing and syndicated loans. In addition, FMO manages several development funds and their associated risks on behalf of the government.

Until 1991, FMO was a subsidized policy vehicle of the government that financed investments in developing countries, mostly in the private sector. In 1991, the signed agreement between the state and FMO clearly defined a

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more commercial approach for FMO. At the same time, a focus on private-sector operations conferred on the company a relatively large degree of management and operational independence, in our view. The agreement was last amended in 1998, mainly to reassert its validity over the longer term, as well as to extend and comprehensively define the government's financial support of, and obligations to, FMO. The 1998 agreement has an indefinite term and its termination requires 12 years' notice from either party. Moreover, FMO's authorized share capital comprises 49% "B" shares, which may be held by the private sector, and 51% "A" shares, which may only be issued to, and owned by, the state. Neither state nor private-sector shareholders have shown any interest in altering the ownership structure. The banking license that FMO obtained in March 2008 has not affected the shareholder structure.

According to Article 8 of the 1998 agreement, "The state shall prevent situations arising in which FMO is unable to meet (its financial) commitments on time." The article comprehensively lists the types of obligations covered by this undertaking. This obligation exists solely between the state and FMO. The company's creditors do not have a direct claim against the state and Article 8 does not formally constitute a full, unconditional guarantee. Nevertheless, we believe the pledge effectively ensures that FMO's obligations are fully supported by the state's credit standing. The Dutch central bank has allowed a 0% risk weighting to all the financial instruments and loans to FMO specified in Article 8. We think the robustness of the state's backing of FMO's obligations is further underpinned by the constitutionally binding nature of the 1998 agreement, which is an obligation for the state rather than the current government. Moreover, unlike other obligations that the state has toward FMO, Article 8 cannot be suspended under any circumstances while the agreement remains in force (Article 10).

Article 7 of the 1998 agreement also stipulates the state's "maintenance obligation" toward FMO, which, unlike the guarantee on the company's financial liabilities, can be suspended. Under this obligation, the state is committed to covering all FMO's losses from unforeseen and nonprovisioned operational risks that cannot be covered by the general reserve risk fund.

If FMO's financial situation were to deteriorate to the extent that it could be expected to invoke the state's obligations, the Ministry of Finance would be entitled to direct the company's financial and economic policies. Under such a scenario, FMO's failure to comply with the minister's directions could result in the suspension of the maintenance obligation, although the likelihood of such a suspension seems remote, in our view, because cooperation between the state and FMO has always been good. If FMO were liquidated, its capital reserves would fall due to the state after settlement of the contractual return to shareholders.

Additionally, state support for FMO is demonstrated by the funding the company has received in the past. From 1991 to 2005, FMO received annual average capital contributions of over €45 million from the Dutch government. Given that FMO now has a very strong capital base relative to its business, the state's capital contributions are not expected to resume in the next few years. However, we understand that the Dutch state is committed in principle to future capital contributions if an expansion of FMO's loan portfolio requires it. We view FMO as also benefiting from advantageous bilateral tax treaties and de facto preferred creditor treatment in certain of FMO's countries of operation.

After the formation of a new Dutch government in 2010, the importance of FMO's activities to the government and the strength of its mandate were again reaffirmed by a pledge to increase its funding to FMO by some €40 million per year. Although small relative to its commitments, we view this as a strong sign of continued government support.

Operations: Strong Recovery In 2010

Despite a dip in overall levels of new commitments in 2009, FMO demonstrated its resilience during the global crisis by maintaining the growth level of its new commitments while commercial investors became less willing to invest in developing countries. The level of new commitments picked up throughout 2010 and increased by over 13% from 2009, totaling just over €1 billion. Moreover, FMO increased by 46% the rate of new commitments in first-half 2011 over the same period in 2010. The quality of FMO's loan portfolio improved in 2010 after a slight deterioration in 2009. However, loan write-offs remain marginal along with the amount of nonperforming and restructured loans. In the case of loan restructurings, which are typically 3% to 4% of loans, FMO normally charges a restructuring fee and increases the rate it charges to the client.

FMO continued its strategy of engaging in transactions with counterparties in developing countries throughout 2010. FMO's activities focus on three core sectors, namely financial institutions (53% of FMO's committed portfolio), energy (14%), and housing (8%). It developed this strategy in the first half of 2011 by increasing transactions related to agribusiness, food, and water, FMO's fourth core sector. Additionally, FMO has stepped up its role as a "catalyst" investor, encouraging commercial investors to engage in frontier markets through syndicated loans. To this end, syndicated transactions have increased during first-half 2011; however, we expect that commercial banking institutions will limit their longer-term exposures to high-risk transactions given the increasingly uncertain operating environment.

The portfolio share of the three priority sectors remained static throughout 2010, at 74% of its total committed portfolio. In 2010, the proportion of counterparties from low-income countries in FMO's portfolio increased to 42%, compared with 36% three years earlier. Regionally, the largest share of FMO's portfolio remains in Africa (28%), with slightly smaller shares in Asia, Latin America, Europe, and Central Asia, in descending order. In terms of new commitments, 55% were made to low-income countries over the first half of 2011, compared to 48% over the first half of 2010.

New commitments have not yet returned to pre-crisis levels and we think that it is unlikely they will return to 2007 and 2008 levels during 2012. Although risk aversion of market participants can benefit FMO, key challenges are still-volatile demand for FMO's products, especially considering the higher short-term liquidity levels prevalent in low-income countries. We think the size of both FMO's portfolio and balance sheet will remain volatile due to exchange rate movements: its operations are denominated in U.S. dollars (about 75% of assets), euro (11%), and various other currencies (14%).

FMO's overall investment decisions must adhere to the principles stated in the Criteria Memorandum (an appendix to the 1998 agreement). In addition to promoting economic development in emerging economies, environmental and social factors are key for FMO when it considers investment projects. In addition to these investment criteria, FMO's management has established exposure limits by country, client, sector, and guarantor, in order to diversify risk.

Policies governing lending decisions

FMO's main activity is to provide loans. Lending and guarantee operations include project finance, corporate loans, and lines of credit to financial institutions, which in turn onlend to local companies. In line with its mandate to operate commercially, the company provides funding on similar terms and conditions to those found in global financial markets.

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FMO calculates what interest rate to charge by adding a spread over its own basic rate for fixed-rate loans, or over LIBOR or an equivalent benchmark for floating-rate loans. The spread generally varies between 200 basis points (bps) and 500 bps, reflecting borrower and country risks, the maturity of the loan, and the current situation in the financial markets. In addition, FMO mobilizes funds from commercial banks through nonrecourse loan syndication. The company provides part of the funds for the loan and serves as the lender of record for the entire facility.

Policies governing equity investments

FMO's equity investments are increasing each year because of the company's efforts to diversify its product mix and meet the needs of clients. FMO's equity investments comprise common and preference shares, subordinated loans with equity options, and other quasi-equity instruments. FMO almost always takes a minority equity investment and is only the largest shareholder in one subsidiary; we understand it is willing, in certain cases, to take seats on company boards.

The company's equity investments have an average duration of five years. In addition, exit arrangements, preferably through stock markets, are agreed at the outset. FMO participates in private equity funds, which in turn take stakes in local firms not listed on the relevant stock exchange. FMO's management tightened its equity investment policies in 2001: Investment criteria became stricter, portfolio management gained greater importance, and we understand that the company paid more attention to generating cash flow, collaborating with partners, and improving the structure and completion of exits.

Local currency financing and new products

FMO is involved in local-currency financing because foreign banks are often unable to offer local currency on longer tenors. Local-currency products have always been available to clients through government funds, but more recently FMO has started introducing its own products. FMO hedges all currency risk for its own products through The Currency Exchange Fund (TCX; A-/Stable/A-2), of which FMO is an important shareholder.

Policies governing provisions

The company introduced a specific loan provisions policy in 2003, linking the provision ratio (25%-100%) to internal ratings and the duration of arrears. A new value-adjustment policy has introduced the concept of incurred but not reported (IBNR) provisions, in accordance with International Financial Reporting Standards. IBNR provision relates to risks that are present but not yet identified, calculated with a model that depends on factors such as country ratings, portfolio breakdowns, default risks, and recovery rates.

Table 1

FMO Balance Sheet

(Mil. €)	2011 H1	2010	2009	2008	2007	2006	2005	2004
Total assets	4,387	4,305	3,772	3,654	2,685	2,306	2,329	1,845
Total Loans (net)	2,137	2,269	1,942	1,763	1,316	1,130	1,010	902
Of which loans guaranteed by the State	56	56	37	40	40	32	18	17
Equity investment	729	688	531	456	338	216	128	93
Cash and interbank holdings	440	352	359	471	184	115	373	149
Marketable securities	583	559	625	564	586	634	627	569
Other assets	498	437	352	440	302	243	210	148
Total liabilities	2,804	2,791	2,445	2,425	1,503	1,223	1,379	1,061
Debt securities	2,352	2,365	2,181	1,295	1,118	1,004	1,139	895
Of which short-term		237	865	232	262	664	752	42

Table 1

FMO Balance Sheet (cont.)								
Banks	338	279	148	1,016	244	44	29	65
Customer deposits	0	0	0	0	0	0	0	0
Other liabilities	115	147	117	115	141	175	211	101
Capital	1,583	1,514	1,327	1,229	1,182	1,083	950	784
Of which share capital (paid-in)	9	9	9	9	9	9	9	9
Of which reserves	1,574	1,505	1,318	1,220	1,173	1,074	941	775

Profitability: Toward Pre-Crisis Levels In 2010, But Outlook Is Less Positive

The volatility of the company's annual results remains a salient feature for our assessment of the ratings, especially as the levels of equity and mezzanine financing increase. However, we believe FMO can partly manage the volatility within its annual profits through the spreads it charges customers for financial products.

Return on average assets increased substantially in 2010 to 3.1% from 1.6% in 2009. However, profitability still remains below pre-crisis levels, when the return on average assets averaged 3.9% over 2004-2007. The level of value adjustments in 2010 almost halved from 2009 levels, partly explaining the increase in profitability alongside a reduction in provisions to 13.1% of revenues, the lowest level since 2006. This was partly as a result of very high provisioning in 2008 and 2009 and quicker-than-expected recoveries in related transactions. Typically, provisioning is FMO's largest annual expense and has averaged 33% of revenues between 2001 and 2009. Similarly, return on equity increased from 4.7% in 2009 to 8.9% in 2010, but remain below the 10.3% average between 2005 and 2007.

Provisioning for equity exposure as a proportion of average equity investments remained at historically low levels, although slightly increased over 2009 levels at 1.8%, compared with 7% in 2008 and an average of 5.8% since 2001 (see table 3).

FMO's main source of income remains the net interest on its loan portfolio at 59% of total revenues in 2010 (65% in 2009). Income from equity transactions remains the most variable part of FMO's income, and has varied between 2% to 41% of total income between 2001 and 2009. We expect this trend to continue alongside increasingly uncertain market conditions. We also note that remuneration for services rendered on behalf of the state tends to oscillate between €20 million and €25 million, which helps to stabilize FMO's otherwise volatile profitability. However, income from related activities dropped slightly below this range in 2010 for the first time since 2004.

According to the 1998 agreement, FMO allocates most of its net profits to the contractual reserve. This usually reduces the distributable profit by about 95%. The management and supervisory boards then propose to shareholders how to appropriate the remaining net profit. As a result, FMO's dividend payout ratio is very low: 1.0% in 2010, which was below the 2001-2009 average of 2.5%.

Table 2

FMO Profit and Loss Account									
(Mil. €)	**2011/H1**	**2010/H1**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**
Income	115	89	225	166	210	199	202	134	127
Net interest income	71	65	133	109	106	102	92	80	80
Income on equity investments	25	14	52	27	87	78	81	11	16

Table 2

FMO Profit and Loss Account (cont.)									
Of which Dividend Income	6	7	15	11	8	6	7	2	2
Remuneration for services rendered*	8	9	19	21	25	24	23	23	19
Other income	6	(6)	6	(1)	(17)	(11)	0	19	9
Expenses	32	29	79	104	180	87	41	33	71
Operating expenses	24	24	50	52	56	51	47	41	36
Value adjustments	8	5	29	52	124	35	(6)	(8)	35
Of which to loans	0	4	9	50	96	26	(9)	(13)	33
Of which to equity	11	6	11	6	28	9	2	5	2
Of which to guarantees	(3)	(4)	10	(4)					
Of which general value adjustment	0	0	0	0	0	0	0	0	0
Profit before tax	85	65	151	61	37	116	165	101	55
Taxes	16	14	25	1	(11)	11	31	28	18
Net profit	69	52	126	60	48	105	134	73	37

Funding And Liquidity: Benefit From Good Market Access

FMO's principal source of funds is domestic and international financial markets, to which the company has good access, in our view. Access to domestic markets has been facilitated by the 0% risk weighting of FMO's obligations in the balance sheets of Dutch financial institutions. We regard FMO's global medium-term note program, with a limit of €3 billion, as its key funding vehicle.

In addition, FMO has a €1.5 billion euro commercial paper program in place, although it had not issued under this program at the time of publication. We rate the program at 'A-1+' on the back of strong sovereign support, including the operating maintenance obligation and the solvency commitment from the State of The Netherlands. Additionally, given FMO's bank status, it has access to funding at the European Central Bank (ECB; AAA/Stable/A-1+), although we note that FMO has never accessed central bank facilities in practice. Over 90% of the interest-bearing securities that FMO holds on its balance sheet (about €560 million as of year-end 2010) are eligible for sale and repurchase agreements (repos) at the ECB.

FMO holds about 8% of its assets as cash-on-hand and short-term deposits. This is less than the record high in 2008, when FMO raised an untypically large amount of short-term funding in order to warehouse a large part of those receipts (to be prepared in case the financial crisis had deepened). Including marketable securities, liquid assets declined to 21% of total assets in 2010, reducing the liquidity buffer available to FMO. Internal liquidity risk guidelines require FMO to hold liquidity sufficient to cover at least six months of payment obligations. We estimate that if committed bank lines and possible repo-operations are included, FMO holds liquid resources sufficient to cover between seven to eight months of its payment obligations.

Capital: Remains Well-Capitalized Relative To Risk Profile

Because of its activities in what we consider to be high-risk countries, FMO has a much higher risk profile than that of commercial banks. On average, FMO's level of risk weighting assets is two to three times higher than that of commercial banks. Even so, we regard FMO as well-capitalized relative to the high-risk profile of its operations. The

standardized Bank of International Settlements ratio is about 30%.

As of year-end 2010, total shareholder equity was €1.5 billion. The reserve allocation policy followed by the company has historically ensured that the ratio of adjusted common equity to total assets has remained at more than 40%, even during times of weaker performance. Since 2008, however, the ratio decreased to the mid-30s--although we note this drop is partly due to exchange-rate effects because equity is 100%-denominated in euros while only a small share of its assets are denominated in euros.

In addition, the company's equity includes the share premium reserve, the Development Fund, the contractual reserve, and other reserves. The share premium reserve contains funds that the government transferred during FMO's financial restructuring in 1991. The Development Fund includes the annual budgetary allocations made by the state. The annual contributions, which ended in 2005, increased the balance of the Development Fund to €658 million. The contractual reserve includes the share of the annual profit that FMO is obliged to allocate under the terms of the 1998 agreement. The remainder of FMO's net profit, after deductions for the proposed dividend, is added to other reserves. We believe the low dividend payout ratio provides management with ample flexibility to translate operating results into equity increases.

Table 3

FMO Financial Ratios

	2010	2009	2008	2007	2006	2005	2004
Profitability							
Revenues/average assets	5.6	4.5	6.6	8	8.7	6.4	7
Net interest income/average assets	3.3	2.9	3.4	4.1	3.9	3.8	4.5
Non-interest expense/average assets	1.2	1.4	1.8	2.1	2	2	2
Pretax profits/average assets	3.7	1.7	1.2	4.7	7.1	4.8	3.1
Net profit/average assets (ROA)	3.1	1.6	1.5	4.2	5.8	3.5	2.1
Return on equity (ROE)	8.9	4.7	4	9.3	13.2	8.5	4.9
Net interest income/revenues	59.1	65.4	50.7	51.5	45.3	59.3	63.2
Non-interest expense/revenues	22.1	31.3	26.5	25.7	23.4	30.6	28.5
Provisions/revenues	13.1	31.1	59.3	17.8	(3.1)	(5.9)	27.9
Pretax profits/revenues	67.2	36.9	17.8	58.4	81.4	75.3	43.8
Revenue/employee (000 €)*	834	629.9	841.8	843.2	902.2	660.6	642.1
Net profit/employee (000 €)*	467.5	226.9	193.2	444.9	598.7	361.6	189.3
Liquidity (% of assets)							
Cash and deposits	8.2	9.5	12.9	6.9	5	16	8
Capital (%)							
Capital/assets	35.2	35.2	33.6	44	47	40.8	42.5
Capital/loans	66.7	68.3	69.7	89.9	95.8	94.1	86.9
Dividend payout ratio	1	2.5	4.6	2.1	1	0.3	0.6
Asset quality (%)							
Loan write-offs/average loans	0.3	0.5	0.4	0	0.9	1.4	3.6
Provisioning for loans/average loans (gross)	0.4	2.7	6.3	2.1	(0.8)	(1.4)	3.8
Provisioning for equity/average equity investments	1.8	1.2	7	3.3	1.4	4.5	2.7
General provisioning/average assets	0	0	0	0	0	0	0
Employees	270	264	249	236	224	203	197

Ratings Detail (As Of March 8, 2012)	
Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.	
Issuer Credit Rating	AAA/Negative/A-1+
Senior Unsecured (111 Issues)	AAA
Issuer Credit Ratings History	
17-Jan-2012	AAA/Negative/A-1+
07-Dec-2011	AAA/Watch Neg/A-1+
18-Jul-2000	AAA/Stable/A-1+

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