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Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.

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Table Of Contents

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Major Rating Factors

Issuer Credit Rating
AAA/Stable/A-1+

Strengths:

- Almost certain government support in an 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 (AAA/Stable/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 one of the government's vehicles 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 strong sovereign support for the company, based on the operating maintenance obligation and the solvency commitment, as well as a track record of support. FMO is a key instrument in the pursuit of the government's official policy of international cooperation.

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 is a leading European development finance institution. In 2009, the company's total assets amounted to €3.8 billion and shareholder equity was €1.3 billion, which equates to35% of assets, slightly up from the level in 2008. The company supports businesses and financial institutions in developing countries with capital and skills. It does so by arranging loans (€1.9 billion in 2009), equity investments (€489 million), guarantees (€114 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 2009, FMO's assets withstood the financial and economic crisis better than management had anticipated, in our view. FMO remained profitable during 2009, although income dropped by 21% year on year to €166 million. Lower results from the exit of equity investments were the main cause of this drop: a €16 million profit equated to a 70% year-on-year decrease, but this remains higher than the level achieved before 2006.

Net interest income of €109 million was more or less flat when compared with the amount in 2008. Due to extensive provisioning in 2008, value adjustments decreased by almost 60% during 2009 to €52 million, leading to a 25% year-on-year increase in net profits to €60 million. Because FMO only pays out a small share of profits as dividends, shareholder equity rose to 35.2% of total assets, from 33.6% in 2008. 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 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. However, the Dutch state is committed in principle to future capital contributions if an expansion of FMO's loan portfolio requires it. 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 the government arm that financed investments in developing countries, mostly in the private sector. In 1991, the signed agreement between the state and FMO clearly defined a 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 credit status in certain of FMO's countries of operation.

Operations: Resilient During The Financial Crisis

Although excess liquidity in the global financial markets significantly affected FMO's activities in 2006 and 2007, liquidity dried up in 2008 when commercial investors became less willing to invest in developing countries. In response, FMO focused on supporting its existing customers in order to weather the adverse economic conditions and the level of new commitments only picked up toward the end of 2009.

In 2009, we note that arrears have risen slightly and the quality of the loan portfolio has declined, according to FMO's internal scoring system. Nevertheless, real losses and write-offs have remained marginal.

FMO introduced a new strategy in 2009, focusing its financial activities on transactions with financial sector counterparties in developing countries (53% of the portfolio in 2009), the housing sector (7%), and energy (14%)--all of which, we understand, were in accordance with FMO's overarching objective of sustainable development. The portfolio share of the three priority sectors has marginally increased to 74% in 2009, up from 73% a year earlier. In 2009, 40% of FMO's portfolio was to counterparties in low-income countries, as compared with 36% two years earlier. Regionally, the largest share of FMO's portfolio is in Africa (29%), with slightly smaller shares in Asia, Latin America, Europe, and Central Asia, in descending order.

Preliminary evidence supports our belief that the quality of FMO's portfolio bottomed out in 2010, although we note that new commitments have not returned to pre-crisis levels. This is consistent with management's desire to pursue only moderate growth strategies in the years to come. We think the size of both FMO's portfolio and balance sheet will remain volatile due to exchange rate movements: much of its operations are denominated in U.S. dollars (about 65% of assets), as well as the euro (20%), and various other currencies (15%).

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.

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 never takes more than a minority equity investment and is never the largest shareholder, although in certain cases we understand it is willing 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 also provides management support and 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 (15%-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. €)	2009	2008	2007	2006	2005	2004	2003	2002	2001
Total assets	3,772	3,654	2,685	2,306	2,329	1,845	1,748	1,458	1,498
Loans (net)	1,905	1,723	1,276	1,099	992	885	848	829	962
Equity investment	531	456	338	216	128	93	82	75	104
Cash and interbank holdings	359	471	184	115	373	149	440	349	235
Marketable securities	625	564	586	634	627	569	148	107	128
Other assets	352	440	302	243	210	148	231	97	70
Total liabilities	2,445	2,425	1,503	1,223	1,379	1,061	1,015	782	864
Debt securities	2,181	1,295	1,118	1,004	1,139	895	914	648	777
Of which short-term	865	232	262	664	752	42	108	47	61
Banks	148	1,016	244	44	29	65	12	49	61
Other liabilities	117	115	141	175	211	101	90	85	26
Capital	1,327	1,229	1,182	1,083	950	784	733	675	633
Of which share capital (paid-in)	9	9	9	9	9	9	9	9	9
Of which reserves	1,318	1,220	1,173	1,074	941	775	724	666	624

Profitability: Recovering As Provisioning Needs Decline

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.

After a number of years of high returns on assets and equity, profitability decreased in 2008. A high level of value adjustments in 2008, as a result of increased risk in the portfolio, offset the still strong results on equity participations. In the past, these participations have provided a significant boost to profitability. Return on average assets amounted to 1.6% in 2009, similar to the return in 2008 (1.5%), but a notable decline compared with the very elevated levels of 2005-2007 (average of 4.5%). The return on equity was 4.7% in 2009, which was also marginally up from the level of the previous year, but less than the average in 2005-2007 (10.3%).

FMO's profitability recovered in 2009 because value adjustments decreased following the aggressive provisioning a year earlier (see table 2). Provisioning for loans as a share of total average loans dropped to 2.5% in 2009, roughly in line with the 10-year average, following an all-time high of 6.4% in 2008. Provisioning for equity exposure as a proportion of average equity investments actually dropped to its lowest level in a decade in 2009, to 1.2%, compared with 7% in 2008 and an average of 5.8% since 2001 (see table 3).

Despite this profit-enhancing reduction in provisioning, FMO's net profit rose only moderately in 2009 to 1.6% of average assets, compared with 1.5% in 2008 and a 10-year average of 2.3%. We think the main reason behind this was 2009 proving to be a particularly challenging year for equity exits, reducing revenue as a share of average assets to a low 4.5%, from 6.6% in 2008--the latter of which is broadly in line with the long-term average.

FMO's main source of income remains the net interest on its loan portfolio. In 2009, this increased to 65% of total revenues in 2009 (51% in 2008) because income from equity transactions fell prey to adverse market conditions. We 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.

Typically, FMO's biggest expense is its provisioning (including equity value adjustments). In 2008, this was the case when provisions amounted to 60% of revenues. However, this has since decreased to 31% in 2009, which is in line with the long-term average (see table 3).

According to the 1998 agreement, FMO must first allocate its net profits to cover any losses incurred in previous years, after which the company makes the required transfer to the contractual reserve. This usually reduces the distributable profit by about 95%. Management and the supervisory board then decide how to appropriate the remaining net profit. As a result, FMO's dividend payout ratio is very low: 2.5% in 2009, which was equal to the 2001-2009 average.

Table 2

FMO--Profit And Loss Account

(Mil. €)	2009	2008	2007	2006	2005	2004	2003	2002	2001
Income	166.3	209.6	199.0	202.1	134.1	126.5	104.6	94.6	91.9
Net interest income	108.8	106.2	102.4	91.5	79.5	80.0	75.6	76.1	76.5
Income on equity investments	16.3	78.4	72.5	73.9	9.4	13.7	6.6	2.6	2.0
Remuneration for services rendered*	21.3	25.2	23.5	23.3	22.7	19.1	18.6	14.1	10.8
Other income	3.8	(11.1)	(8.5)	4.6	20.0	11.1	3.8	1.7	2.6
Expenses	103.8	179.9	86.7	41.1	33.2	71.2	75.4	84.9	93.9
Operating expenses	52.0	55.5	51.2	47.3	41.1	36.0	33.2	30.5	25.4
Value adjustments	51.8	124.3	35.4	(6.2)	(7.9)	35.3	42.2	54.4	68.5
Of which to loans	46.1	96.4	26.2	(8.7)	(13.0)	32.9	20.3	27.4	61.7
Of which to equity	5.7	27.9	9.2	2.4	5.0	2.4	2.8	8.3	20.4
Of which general value adjustment	--	--	--	--	--	--	19.1	18.8	(13.6)
Profit before tax	61.3	37.4	116.3	164.6	101.0	55.4	29.3	9.1	(2.0)
Taxes	1.3	(10.7)	11.3	30.6	27.6	18.0	8.7	4.6	(6.2)
Net profit	59.9	48.1	105.0	134.1	73.4	37.3	20.6	4.6	4.3

*Mostly services rendered to the state plus syndication fees.

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 'A-1+' on the back of the 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 €630 million as of year-end 2009) are eligible for sale and repurchase agreements (repos) at the ECB.

FMO holds about 10% 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 increased to 26% of total assets in 2009, which further increases 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 about one year of its payment obligations.

Capital: 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 2009, total shareholder equity was €1.3 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 euro while only a small share of its assets are denominated in euro.

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

	2009	2008	2007	2006	2005	2004	2003	2002	2001
Profitability (%)									
Revenues/average assets	4.5	6.6	8.0	8.7	6.4	7.0	6.5	6.4	6.3
Net interest income/average assets	2.9	3.4	4.1	3.9	3.8	4.5	4.7	5.2	5.3
Non-interest expense/average assets	1.4	1.8	2.1	2.0	2.0	2.0	2.1	2.1	1.7
Pretax profits/average assets	1.7	1.2	4.7	7.1	4.8	3.1	1.8	0.6	(0.1)
Net profit/average assets (ROA)	1.6	1.5	4.2	5.8	3.5	2.1	1.3	0.3	0.3
Return on equity (ROE)	4.7	4.0	9.3	13.2	8.5	4.9	2.9	0.7	0.7
Net interest income/revenues	65.4	50.7	51.5	45.3	59.3	63.2	72.3	80.4	83.2
Non-interest expense/revenues	31.3	26.5	25.7	23.4	30.6	28.5	31.7	32.2	27.6
Provisions/revenues	31.1	59.3	17.8	(3.1)	(5.9)	27.9	40.3	57.5	74.6
Pretax profits/revenues	36.9	17.8	58.4	81.4	75.3	43.8	28.0	9.6	(2.2)
Revenue/employee (000 €)*	591.8	841.8	843.2	902.2	660.6	642.1	533.7	492.7	560.4
Net profit/employee (000 €)*	213.2	193.2	444.9	598.7	361.6	189.3	105.1	24.0	26.2
Liquidity (% of assets)									
Cash and deposits	9.5	12.9	6.9	5.0	16.0	8.0	25.1	24.0	15.7
Net loans	50.5	47.2	47.5	47.6	42.6	48.0	48.5	56.9	64.2
Capital (%)									
Capital/assets	35.2	33.6	44.0	47.0	40.8	42.5	41.9	46.3	42.3
Capital/loans	69.7	71.3	92.6	98.6	95.8	88.6	86.4	81.4	65.9
Dividend payout ratio	2.5	4.6	2.1	1.0	0.3	0.6	1.1	5.0	5.4
Asset quality (%)									
Loan write-offs/average loans	0.5	0.4	0.0	0.9	1.4	3.6	3.4	2.7	0.4
Provisioning for loans/average loans (gross)	2.5	6.4	2.2	(0.8)	(1.4)	3.8	2.4	3.1	5.1
Provisioning for equity/average equity investments	1.2	7.0	3.3	1.4	4.5	2.7	3.6	9.3	19.3
General provisioning/average assets	0.0	0.0	0.0	0.0	0.0	0.0	1.2	1.3	(0.9)
Employees	281	249	236	224	203	197	196	192	164

*Assuming constant headcount throughout the years.

Ratings Detail (As Of November 23, 2010)*

Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured (121 Issues)	AAA
Issuer Credit Ratings History	
18-Jul-2000	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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