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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
AA+/Stable/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 equalized with the ratings on The Netherlands (unsolicited ratings, AA+/Stable/A-1+), reflecting our opinion that there is an "almost certain" likelihood that the Dutch government would provide timely and sufficient extraordinary support to FMO in the event of financial distress.

In accordance with our criteria for government-related entities, 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 FMO. The ratings reflect the 51% government ownership of, and strong sovereign support for, the company, based on the operating maintenance obligation, liquidity provisions, and the solvency commitment, as well as the 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 by providing liquidity. 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). We understand that although the state does not explicitly guarantee FMO's individual obligations, it views its maintenance guarantee on FMO's operations as equivalent to an explicit guarantee. FMO's creditors have no direct recourse to the Dutch government. Rather, the government's obligation is to FMO.

FMO supports businesses and financial institutions in developing countries by providing capital and skills. It does so by arranging loans (€2.9 billion net loans outstanding on June 30, 2013; equity investments €973 million), guarantees, and other investment promotion activities. In addition, it manages several off-balance-sheet development funds on

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behalf of, and at the risk of, the Dutch government: these were approximately 10% of FMO's total assets at the end of June 2013. The Dutch government apportioned an additional €140 million to FMO over 2013, highlighting FMO's importance in achieving government development policy. FMO's dividend policy has also changed slightly; the government may now take an increased dividend of up to 100% of distributable profit (about 5% of total profit), compared with 40%-60% previously. We view this as a reflection of the significant capital provided to FMO by the government.

FMO's net profitability improved by over 50% in 2012 over 2011, to €146 million, mainly thanks to improved income from equity investments and lower provisioning. Net interest income, the most significant component (nearly 60%) of FMO's revenues, also grew slightly. However, we continue to expect FMO's operating environment, particularly with regards to equity investments, to remain challenging. The sale of investments, where possible, continues to yield less than before the crisis, despite robust emerging market growth. Investment fund participation grew by nearly 20% over 2012, but this has depressed related revenue because funds typically do not invest over their first few years. Looking forward, we expect that FMO's on-balance-sheet growth will remain steady at about 5%-7% per year, in line with management's expectations, tempered slightly by some deterioration in asset quality (nonperforming loans are in the region of 4%). We expect fee revenue to increase from current levels (8% of total income) as FMO pursues more ambitious off-balance-sheet growth in line with its stated aim of becoming the leading impact investor globally. Given the nature of its business and the high level of equity and mezzanine financing, we view FMO's financial results as fairly volatile. Based on FMO's track record of managing emerging market risks, we expect that the company will remain profitable.

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.

Should we receive new information that would lead us to reassess FMO's integral link and critical role with respect to the Dutch government, we could lower the rating to below that of the State of The Netherlands.

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 Netherlands. Furthermore, we view the link between the government and FMO as "integral." This latter view is supported by the government's track record of lending 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.

The relationship between the State and FMO is set out in a formal agreement first signed in 1991 and amended in 1998 (for the full text see http://www.fmo.nl/l/nl/library/download/urn:uuid:615c9ec5-0066-4844-a301-17de1952ff60/the+agreement-98.pdf). The 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. 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 operational risks that are unforeseen and not provisioned for, and 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, we believe that 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, we do not expect that the state's capital contributions will 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. In our view, FMO also benefits from advantageous bilateral tax treaties and de facto preferred creditor treatment in some of FMO's countries of operation.

Over 2011, FMO made 8% more loans and equity investments on behalf of and at the risk of the Dutch government than in the previous year. Although the number stayed at a similar level in 2012, we view the prior increases as evidence of FMO's policy importance to the Dutch government and the government's continued support for its activities and expertise.

Operations

During 2012, new commitments increased by 6% to €1.4 billion, higher than they were before the crisis. We expect that new commitments have continued to grow at a similar pace over 2013 and will continue to do so during 2014. As before, projects in Africa account for the largest share of new contracts, at about one-third as of year-end 2012. Remaining new commitments are evenly split between Asia, Latin America and the Caribbean, and Eastern Europe and Central Asia. In terms of sector, financial institutions account for the largest share at 52% of new commitments, followed by energy.

FMO's recently rapid loan growth is mostly explained by commercial banks pulling back from emerging markets, particularly for loans of longer duration, allowing FMO to capture new business and to emphasize its relevance to anticyclical development.

The quality of FMO's loan portfolio deteriorated slightly in 2012, with the nonperforming loan (NPL) ratio increasing from 3.4% to 3.9%. (NPLs are loans with interest or principal payments overdue by over 90 days, including guaranteed loans.) As of end-June 2013, the NPL ratio further had deteriorated to 4.2%--but remains low, in our view, considering the risk inherent in FMO's portfolio. Loan write-offs remained marginal in 2012, accounting for just 0.6% of the gross portfolio. In the case of loan restructurings, which typically affect 3% to 4% of loans, FMO normally charges a restructuring fee and increases the rate it charges to client.

FMO's current focus sectors are financial institutions (56% of total portfolio at year-end 2012), energy and agribusiness (18%), and food and water (7%). Together with financial partners (German and French development financial institutions DEG and Proparco, International Finance Corp., and others), FMO also finances projects outside its main strategic focus sectors. These are aggregated as "Diverse Sectors," and accounted for 19% of the total committed portfolio at year-end 2012. Additionally, encouraging private investors to engage in frontier markets through syndicated loans and various risk-sharing agreements remains a priority.

In 2012, the proportion of commitments to counterparties from low-income countries in FMO's portfolio was 43%, compared with 36% four years earlier, reflecting FMO's ambition to maximize its developmental impact. Regionally, the largest share of FMO's portfolio remains in Africa (30%), with slightly smaller shares in Asia, Latin America, Eastern Europe, and Central Asia, in descending order.

Although the risk aversion of market participants can benefit FMO, a key challenge is the still-volatile demand for FMO's products, especially considering the higher levels of short-term liquidity prevalent in low-income countries. We expect that FMO's equity portfolio--and balance sheet--will remain volatile due to exchange rate movements (other operations are effectively hedged against exchange rate fluctuations): its operations are denominated in U.S. dollars (about 73%), euros (16%), and other currencies (11%).

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, to diversify risk.

Policies governing lending decisions

FMO's main activity is to provide loans (approximately €3.0 billion at end 2013, up by 127% since year-end 2007). 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 (€973 million on June 30, 2013, up by 41% since year-end 2010) are increasing each year because of its 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 the largest shareholder in one single case; 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.

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, of which FMO is an important shareholder. At the end of 2013, 11% of net loans to the private sector were denominated in local currency.

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. The value-adjustment policy introduced the concept of incurred but not reported (IBNR) provisions in 2005, 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. €)	**2013 H1**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**
Total assets	5,821.2	5,561.3	5,059.3	4,305.1	3,772.4	3,654.0	2,685.0
Total loans (net)	2,859.0	2,816.5	2,584.7	2,269.0	1,941.9	1,762.6	1,315.5
Of which loans guaranteed by the state	54.2	58.9	62.6	56.3	36.6	39.5	39.5
Equity investment	973.1	913.6	795.4	688.0	530.8	456.1	337.0
Cash and interbank holdings	921.0	700.6	540.9	351.9	358.9	471.0	184.1
Marketable securities	697.0	729.8	666.7	558.7	624.5	564.1	585.6
Other assets	371.1	399.9	471.6	437.5	352.0	439.8	301.9
Total liabilities	3,921.9	3,739.0	3,394.7	2,791.3	2,445.2	2,425.4	1,502.9
Debt securities	3,384.3	3,291.7	2,678.5	2,365.3	2,180.6	1,295.2	1,117.9
Short-term credits*	183.1	240.4	558.0	279.0	148.0	1,016.0	242.0
Banks	45.9	27.8	0.0	0.0	0.0	0.0	2.0
Customer deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	308.6	179.1	158.5	147.4	116.6	114.0	140.9
Capital	1,899.3	1,822.3	1,664.6	1,513.8	1,327.2	1,228.6	1,182.2
Of which share capital (paid-in)	9.0	9.0	9.0	9.1	9.1	9.1	9.1
Of which reserves	1,890.3	1,813.0	1,655.6	1,504.7	1,318.1	1,219.5	1,173.1

*Predominantly collateral and deposits.

Profitability returns but downside persists

We expect the company's annual results, especially as levels of equity and mezzanine financing increase, to remain relatively volatile. 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 to 2.9% in 2012, up from 2% in 2011. This is close to 2010 levels, but still below the 3.9% average in 2004-2007. Value adjustments fell in 2012, helping to boost net profits to €146 million from €93 million in 2011. We expect that the poor operating environment will continue to make it more difficult for FMO to recover some of its loans, and we anticipate that value adjustments will remain elevated over the rest of 2013 and 2014.

At the same time, it remains difficult to realize attractive exits for equity investments--related profits are almost half what they were before the crisis. However, provisions for loans as a percentage of average loans declined to 1.2% 2012 from 1.5% in 2011, reflecting an improving environment and FMO's conservative policy. In addition, provisioning for equity almost halved to 2.8% from 4.9%. Profitability in the first half of 2013 remained below budget, primarily because of the lower equity investments exits. However, we expect net profit for 2013 will be close to the company's €100 million target, which FMO significantly exceeded in 2012. Return on equity increased to 8.6% in 2012 from 5.9% in 2011, returning close to the 8.9% 2004-2007 pre-crisis average.

FMO's main source of income remains the net interest on its loan portfolio. At 57% of total revenues in 2012, net interest income was at its lowest proportion of total income since 2008, although in absolute terms it was slightly up on 2011, reaching €154 million. 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 2012. 2012 performance was significantly better than in 2011, increasing to 32% from 19%. Remuneration FMO receives for services rendered on behalf of the state tends to hover around €20 million, which helps to stabilize FMO's otherwise volatile profitability.

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. FMO's dividend pay-out ratio is generally quite low, although it was slightly higher in 2012 at around 4.6%.

The new 2013-2016 strategy is the next step toward the goal of becoming the world's largest impact investor by 2020--and we expect that FMO' will substantially increase its development impact and loan portfolio. Focusing on developing economic growth, poverty reduction, and sustainability, FMO will concentrate its lending in the agricultural and energy sectors, but also clean technologies and financial institutions that promote sustainability. Additional components of the strategy include fund management and syndicated loans.

Table 2

FMO Profit And Loss Account

(Mil. €)	2013 H1	2012	2011	2010	2009	2008	2007
Income	130.5	271.5	237.9	225.2	166.3	209.6	199.0
Net interest income	76.1	153.8	147.0	133.1	108.8	106.2	102.4
Income on equity investments	20.1	89.3	45.8	51.5	26.9	86.7	79.0
Of which dividend income	10.8	17.2	13.6	15.2	10.6	8.3	5.9
Remuneration for services rendered*	10.2	19.1	18.4	19.3	21.3	25.2	23.0
Other income	24.2	9.2	26.7	21.3	9.3	(8.5)	(5.4)
Expenses	51.1	102.1	110.9	79.3	103.8	179.9	86.7
Operating expenses	31.9	56.4	51.5	49.8	52.0	55.5	51.2
Value adjustments	19.2	45.7	59.4	29.5	51.8	124.3	35.4
Of which to loans	7.7	29.1	36.9	8.7	49.7	90.0	20.0
Of which to equity	12.0	22.8	36.3	11.0	5.7	27.9	9.2
Of which to guarantees	(0.5)	(6.3)	(13.8)	9.8	(3.6)	6.0	6.0
Profit before tax	77.4	173.4	117.8	151.4	61.3	37.4	116.3
Taxes	14.3	27.4	24.4	25.2	1.3	(10.7)	11.3
Net profit	63.1	146.0	93.4	126.2	59.9	48.1	105.0

Funding And Liquidity: Both Benefit From Diversified Sources

FMO's principal sources of funds are the 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. We regard FMO's debt issuance program limit of €4 billion as its key funding vehicle.

In addition, FMO has a €1.5 billion commercial paper program in place, although to date it has not issued under this program. Additionally, given FMO's bank status, it has access to funding at the European Central Bank (ECB), 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 €730 million as of year-end 2012) are eligible for sale and repurchase agreements (repos) at the ECB.

FMO's management is actively trying to diversify its funding markets, having issued in U.S. and Australian dollars in the past year, and in some cases paying a premium in order to keep markets open. We expect further euro market activity and possibly yen issuance, conditions permitting.

A substantial portion of the funding FMO planned for 2013 was completed early in the year. FMO has issued a US$500 million bond that has allowed, among other things, an increase in short-term deposits, strengthening FMO's liquidity position in times of financial uncertainty. FMO also successfully arranged €130 million in private placements in June 2013. As a result, FMO held about 16% of its assets as cash-on-hand and short-term deposits as of end-June 2013, an all-time high and reflective of the conservative approach to managing liquidity. 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 seven to eight months 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 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 (BIS) ratio is about 29% as of end-June 2013.

At the beginning of 2012, FMO introduced a more transparent and standardized internal capital model based on Basel's internal-ratings-based methodology for measuring risk. Using the new credit rating approach and expert assessments, probability of default and loss given default are estimated as the main parameters for the model.

As of year-end 2012, total shareholder equity was €1.9 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 has decreased to the mid-30s--although we note this drop is partly due to exchange-rate effects because euros are the denomination of 100% of its equity but only a small share of its assets. FMO's management expects the balance sheet to rise to €6 billion in 2013 and to increase in the region of 5% to 7% per year.

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 pay-out ratio provides management with ample flexibility to translate operating results into equity increases.

Table 3

FMO Financial Ratios						
	2012	**2011**	**2010**	**2009**	**2008**	**2007**
Profitability						
Revenues/average assets	5.5	5.1	5.6	4.5	6.6	8.0
Net interest income/average assets	3.1	3.1	3.3	2.9	3.3	4.1
Operating expense/average assets	1.1	1.1	1.2	1.4	1.8	2.0
Pretax profits/average assets	3.5	2.5	3.7	1.6	1.2	4.6
Net profit/average assets (ROA)	2.9	2.0	3.1	1.6	1.5	4.2
Return on equity (ROE)	8.6	5.9	8.9	4.7	4.0	9.3
Net interest income/revenues	56.7	61.8	59.1	65.7	50.5	51.3
Operating expense/revenues	20.8	21.6	22.2	31.3	26.7	25.6
Provisions/revenues	16.8	25.0	12.9	31.3	59.0	17.6
Pretax profits/revenues	63.9	49.5	67.1	36.7	17.6	58.3
Revenue/employee (000 €)*	887.1	840.7	833.3	628.8	843.4	843.2
Net profit/employee (000 €)*	477.1	330.0	467.5	227.2	192.8	444.9
Liquidity (% of assets)						
Cash and deposits	12.6	10.7	8.2	9.5	12.9	6.9
Capital (%)						
Capital/assets	32.8	32.9	35.2	35.2	33.6	44.0
Capital/loans	64.7	64.4	66.7	68.3	69.7	89.0
Dividend payout ratio	4.6	2.3	1.5	2.5	2.5	2.1
Asset quality (%)						
Loan write-offs/average loans	0.6	0.8	0.3	0.5	0.4	0.0
Value adjustments for loans/average loans	1.2	1.5	0.4	2.7	5.0	1.6
Value adjustments for equity/average equity investments	2.8	4.9	1.8	1.2	7.0	3.3
Employees	306	283	270	264	249	236

Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Long-Term Ratings On The Netherlands Lowered To 'AA+' On Weak Growth Prospects; Outlook Stable, Nov. 29, 2013

Ratings Detail (As Of February 21, 2014)	
Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.	
Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+
Issuer Credit Ratings History	
29-Nov-2013	AA+/Stable/A-1+
17-Jan-2012	AAA/Negative/A-1+
07-Dec-2011	AAA/Watch Neg/A-1+

Ratings Detail (As Of February 21, 2014) (cont.)

*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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