Research

Transaction Update: Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.

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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:

- Volatile income stream.
- High-risk lending profile.

Rationale

Standard & Poor's Ratings Services' ratings on the development finance institution Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO) are equalized with those 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 with the Dutch government. The ratings reflect the 51% government ownership of, and strong sovereign support for FMO, based on the government's maintenance obligation on FMO's operations, its liquidity injections, and its commitment to preserve FMO's solvency, as well as a track record of such support.

The 1998 agreement between FMO and the government formally codified sovereign support to FMO. Under Article 8 of the agreement, the government 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 government 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 (€3.2 billion net loans outstanding on June 30, 2014), equity investments (€996 million), guarantees, and other investment promotion activities. In addition, it manages several off-balance-sheet development funds on behalf of, and at the risk of, the Dutch government: these represented approximately 10% of FMO's total assets at the end of June 2014.

FMO manages the following government funds: financing of Dutch small and midsize enterprises (SMEs) that invest in developing countries; a local currency fund reaching out to SMEs via financial institutions (MASSIF); earmarked funds for infrastructure projects in low-income countries (IDF); a fund financing energy projects (AEF); and capacity development (CD). The latter enables targeted access to know-how, bundled to meet a company's full organizational needs, is financed by the Dutch Minister for Development Cooperation, and stimulates technical cooperation between developing country companies and enterprises in industrialized nations.

The Dutch government allocated an additional €110 million to FMO in 2013, highlighting FMO's importance in achieving government development policy.

FMO's dividend policy has also changed slightly over time. We understand the shareholders, including 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. Between 2007 and 2013, FMO retained on average more than 97% of its annual profits as capital. At 32%, FMO's leverage ratio is very strong, reflecting high levels of equity on the balance sheet, which illustrates the government's commitment to the organization, as well as FMO's consistent profitability.

FMO's 2013 net profitability declined slightly versus 2012's, to €133 million, mainly due to lower equity investment results because of the complex financial market environment. Net interest income, the most significant component of FMO's revenues--just over 60%--grew slightly in 2013, compared with one year earlier. Nevertheless, in 2014, we expect FMO's operating environment, particularly with regard to income on equity investments, to improve, as reflected in first-half 2014 results standing at €42.9 million for the six months, against €43.4 million in full-year 2013. We expect that FMO's loan 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 amount to roughly 4% of total loans).

Given the nature of its business and the high level of equity and mezzanine financing, FMO's financial results are volatile, in our opinion, especially in an uncertain world growth environment. Based on FMO's track record of managing emerging market risks, we expect that the company will remain profitable despite what we consider to be a weakening of current global economic growth conditions. Moreover, in March this year, FMO received its full banking license from the Dutch Central Bank (DNB), further improving its access to the international capital markets and widening its financing options. FMO can now fully benefit from emergency monetary policy measures that the European Central Bank adopts.

Outlook

The stable 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.

If we receive new information that would lead us to reassess FMO's integral link with and critical role for the Dutch government, we could lower the long-term rating to below that on The Netherlands.

If we took a positive rating action on The Netherlands, we would take a similar action on FMO, assuming that FMO continues to enjoy an unchanged role and link with the government.

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. Neither the initial banking license that FMO obtained in March 2008 nor the full license it received in March 2014 have 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 on 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 of 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 Dutch 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. The likelihood of such a suspension seems remote, though, 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 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 more than €45 million from the Dutch government. Given that FMO now has a very strong capital base relative to its business, we do not expect the state to resume capital contributions 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.

In 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 declined slightly in 2012 and 2013, it rose again in 2014. We view this trend as evidence of FMO's policy importance to the Dutch government and the government's continued support for the finance institution's activities and expertise, considering the loans related on behalf of the government more than doubled between 2007 and 2013.

Operations

During 2013, new commitments increased by almost 10% to slightly more than €1.5 billion, higher than precrisis levels. We expect new commitments to grow at a similar pace over 2014, in line with FMO's target of €1.6 billion. As before, projects in low-income and lower-middle-income countries account for the largest share of new contracts, at about €1 billion in 2013. In terms of sector, financial institutions account for the largest share at 53% 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.

Loan write-offs remained marginal in 2013, accounting for just 0.6% of the gross portfolio, and have declined significantly during the first half of 2014 to 0.1%. In the case of loan restructurings, which typically affect 3%-4% of loans, FMO normally charges a restructuring fee and increases the rate it charges clients.

FMO's current focus sectors are financial institutions (53% of total portfolio at year-end 2013), energy (21%), and agribusiness together with food and water (7%). Alongside German and French development financial institutions DEG and Proparco, International Finance Corp., and other financial partners, FMO also finances projects outside its main strategic focus sectors. These are aggregated as "Diverse Sectors," and accounted for 19% of its total committed portfolio at year-end 2013. Additionally, encouraging private investors to engage in frontier markets through syndicated loans and various risk-sharing agreements remains a priority.

Although FMO can benefit from market participant's risk aversion, a key challenge for the financial institution is the still-volatile demand for FMO 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): equity investments are denominated in U.S. dollars (about 62%), euros (22%), and other currencies (16%).

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. Additionally, 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 billion at year-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 lend 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 current financial market conditions. 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 (€996 million as of June 30, 2014, up 44% since year-end 2010) are increasing each year because of its efforts to diversify its product mix and meet client needs. 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 just one 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 upon 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. The IBNR provision relates to risks that are present but not yet identified, and is calculated with a model that depends on such factors as country ratings, portfolio breakdowns, default risks, and recovery rates.

Table 1

Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.--Balance Sheet

(Mil. €)	2014*	2013	2012	2011	2010	2009	2008	2007
Total assets	6,369	6,184	5,564	5,059	4,305	3,772	3,654	2,685
Total loans (net)	3,245	2,981	2,822	2,585	2,269	1,942	1,763	1,316
Of which loans guaranteed by the state	65	54	59	63	56	37	40	40
Equity investment	996	943	891	795	688	531	456	337
Cash and interbank holdings	1,062	1,103	678	541	352	359	471	184
Marketable securities	594	665	730	667	559	625	564	586
Other assets	472	493	444	472	438	352	440	302
Total liabilities	4,351	4,221	3,750	3,395	2,791	2,445	2,425	1,503
Debt securities	3,793	3,610	3,292	2,679	2,365	2,181	1,295	1,118
Short-term credits§	226	227	240	558	279	148	1,016	242
Banks	79	77	28	0	0	0	0	2
Customer deposits	0	0	0	0	0	0	0	0
Other liabilities	252	308	190	159	147	117	114	141
Capital	2,019	1,963	1,815	1,665	1,514	1,327	1,229	1,182
Of which share capital (paid-in)	9	9	9	9	9	9	9	9
Of which reserves	2,010	1,954	1,806	1,656	1,505	1,318	1,220	1,173

*As of June 30, 2014. §Predominantly collateral and deposits.

Profitability returns but downside persists

We expect the company's annual results to remain relatively volatile, especially as 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 declined in 2013 to 2.3% from 2.7% in 2012. This is close to 2010 levels, but still below the 3.9% average in 2004-2007. FMO's net profitability declined slightly in 2013 over 2012, to €133 million, mainly due to lower equity investment results created by complicated financial market environment. Net interest income, the most material component (slightly above 60%) of FMO's revenues, grew slightly. We expect FMO's operating environment, particularly with regards to equity investments, to improve as reflected in the results of the first half of 2014 (€42.9 million compared with €43.4 million for all of 2013). We expect net profit for 2013 will be higher than for 2014. Return on equity increased to 7.1% in 2013 from 8.4% in 2012, not too far from the 2004-2007 pre-crisis average of 8.9%.

FMO's main source of income remains the net interest on its loan portfolio. At 55% of total revenues as of June 30, 2014, net interest income was at its lowest proportion of total income since 2008, and in absolute terms it was slightly up as of June 30, 2013, reaching almost €79 million. Income from equity transactions remains the most variable part of FMO's income, with 2013 performance dropping to about 17% of total income from about 33% in 2012. Remuneration FMO receives for services rendered on behalf of the state tends to hover around €20 million, which helps 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 higher in 2013 at approximately 5%.

According to the management plans, the 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

Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.--Profit And Loss Account

(Mil. €)	2014 H1	2013	2012	2011	2010	2009	2008	2007
Income	144	254	272	238	225	166	210	199
Net interest income	79	155	154	147	133	109	106	102
Income on equity investments	43	43	89	46	52	27	87	79
Of which dividend income	6	20	17	14	15	11	8	6
Remuneration for services rendered	11	23	19	18	19	21	25	23
Other income	11	33	9	27	21	9	(9)	(5)
Expenses	62	80	103	111	79	104	180	87
Operating expenses	34	62	57	52	50	52	56	51
Value adjustments	29	18	46	59	30	52	124	35
Of which to loans	19	3	29	37	9	50	90	20
Of which to equity	7	22	23	36	11	6	28	9
Of which to guarantees	(3)	(2)	(6)	(14)	10	(4)	6	6
Profit before tax	79	169	172	118	151	61	37	116
Taxes	13	36	27	24	25	1	(11)	11
Net profit	66	133	145	93	126	60	48	105

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, although we note that FMO has never accessed central bank facilities in practice.

FMO's management is actively trying to diversify its funding markets, having issued in euros, in Swiss francs, and in U.S., Australian, and New Zealand dollars since 2013. In some cases, FMO has even paid a premium in order to keep markets open.

FMO has been an active issuer over the past few years, including in 2014. This has allowed the finance institution, among other things, an increase in short-term deposits, strengthening FMO's liquidity position in times of financial uncertainty. As a result, FMO held about 17% of its assets as cash-on-hand and short-term deposits as of June 30, 2014, reflective of its 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 about 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 2x-3x 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 stood at 22.8% as of June 30, 2014.

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

As of year-end 2013, 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-30 percentile range--although we note this drop is partly due to exchange rate effects. This is 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 by €1.6 billion in new commitments in 2014 and to increase in the region of 5%-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 state's annual budgetary allocations. 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

Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.--Financial Ratios							
(Mil. €)	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**
Profitability							
Revenues/average assets	4.3	5.1	5.1	5.6	4.5	6.6	8
Net interest income/average assets	2.6	2.9	3.1	3.3	2.9	3.3	4.1
Operating expense/average assets	1.1	1.1	1.1	1.2	1.4	1.8	2
Pretax profits/average assets	2.9	3.2	2.5	3.7	1.6	1.2	4.6
Net profit/average assets (ROA)	2.3	2.7	2.0	3.1	1.6	1.5	4.2
Return on equity	7.1	8.4	5.9	8.9	4.7	4	9.3
Net interest income/revenues	60.9	56.6	61.8	59.1	65.7	50.5	51.3
Operating expense/revenues	24.6	21.1	21.6	22.2	31.3	26.7	25.6
Provisions/revenues	6.9	16.8	25.0	12.9	31.3	59	17.6
Pretax profits/revenues	66.6	63.5	49.5	67.1	36.7	17.6	58.3
Revenue/employee (€000s)	755.7	887.3	840.6	833.3	628.8	843.4	843.2
Net profit/employee (€000s)	396.7	474.8	330.0	467.5	227.2	192.8	444.9
Liquidity (% of assets)							
Cash and deposits	17.8	12.2	10.7	8.2	9.5	12.9	6.9
Capital (%)							
Capital/assets	31.7	32.6	32.9	35.2	35.2	33.6	44
Capital/loans	65.9	64.3	64.4	66.7	68.3	69.7	89
Dividend payout ratio	5.0	1.5	2.0	1.5	2.5	2.5	2.1
Asset quality (%)							
Loan write-offs/average loans	0.1	0.6	0.8	0.3	0.5	0.4	0
Value adjustments for loans/average loans	0.1	1.1	1.5	0.4	2.7	5	1.6
Value adjustments for equity/average equity investments	2.4	2.7	4.9	1.8	1.2	7	3.3
Employees	372	306	283	270	264	249	236

ROA--Return on assets.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Related Research

- The Netherlands 'AA+/A-1+' Ratings Affirmed; Outlook Stable, Nov. 21, 2014

Ratings Detail (As Of March 30, 2015)	
Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.	
Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+

Ratings Detail (As Of March 30, 2015) (cont.)	
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+

*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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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