

CREDIT ANALYSIS

Eurofima

Supranational

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Summary Rating Rationale

The Aaa and P-1 issuer and debt ratings assigned to Eurofima (European Company for the Financing of Railroad Rolling Stock) reflect its strong support mechanisms and guarantee criteria, financing contracts secured by collateral rolling stock, and sound liquidity position.

Eurofima's mission is to provide its European shareholder railways with competitive funding for renewals or modernisation of their rolling stock. The organization does not seek to maximise profits, which tend to be very stable and predictable over time. Profit, after a maximum dividend allocation of 4%, is retained and kept as reserves to strengthen capital. Eurofima maintains adequate and stable liquidity in the form of reserves and funds for general risks, totaling CHF861 million at the end of July 2010. It also benefits from timely access to substantial additional funds through its 80% callable capital from its members (equivalent to CHF2 billion) and several uncommitted credit lines. Eurofima operates under rigid governance practices aimed at minimising key risks – from credit to liquidity, and from operational to financial.

Rating Outlook

The outlook is stable. Eurofima's rating is well positioned in its category given the very high stability of its financial performance over time, the high predictability of its financial planning, and the strong support by the Member States. Over the medium term, Moody's expects continuity in the prudent management and investment decisions seen in the past.

This Credit Analysis provides an in-depth discussion of credit rating(s) for Eurofima and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on [Moody's website](#).

Issuer Overview

Eurofima is a supranational organization established by a Convention, signed and ratified by 25 countries, including the Republic of Montenegro, whose government joined in October 2006. To qualify for membership in Eurofima, a State must be a member of the International Transport Forum (formerly European Conference of Ministers of Transport or ECMT); if the previous condition is not fulfilled, all existing Eurofima members are required to give their approval on any new member.

Established in 1956 as a joint stock company, Eurofima is governed by the Convention, its Articles of Association (Statutes), and – in a subsidiary manner – by the laws of the Swiss Confederation. Any change to the original text of the initially signed Convention requires approval by all Member States, whose relationships are governed by the Basic Agreement (“Accord de Base”).

Significant role in financing European railways

Eurofima was established to provide its shareholder railways with competitive funding for renewals or modernisation of their rolling stock and the company continues to play a key role in this regard. The organization does not seek to maximise profits, but rather to obtain financing under the best possible conditions for its shareholder railways.

To enter into equipment financing contracts with the individual participating railways, Eurofima borrows the necessary funds in the capital markets and advances these to the railways holding the title to – or securing interest in – the rolling stock until the equipment financing contract has been fully paid. Only on payment of the final installment of a contract does the title on the rolling stock pass to the railway. Although Moody's believes that the rolling stock collateral enhances asset quality, we also believe that the actual seizure of a defaulting railway's rolling stock may prove a difficult task in practice.

By the end of 2009, total equipment financing was CHF32.4 billion (book value), a decrease from CHF35.5 billion in 2008. This trend is projected to continue in the foreseeable future as investment volumes are expected to decline. As of July 2010, total equipment financing was CHF29.4 billion and represented the largest single asset accounting for 78.2% of total assets vs. 86.7% in 2009. Equipment-financing contracts are measured at the fair value (or at amortised costs where the fair value option is not applicable). Asset quality remains very high, with neither credit losses nor overdue payments.

Key Rating Considerations

Institutional Framework

Strong support mechanisms

Moody's has assigned Eurofima the highest possible credit ratings for long- and short-term borrowings, based principally on the several levels of support it enjoys:

- » If a railway company's liabilities are not direct government liabilities, the member state must guarantee the equipment-financing contracts
- » Shareholders provide a joint guarantee in proportion to each country's participation in the registered capital and for a maximum of that stated amount

- » A grandfathering clause¹ in the convention assures continuity in the guarantee for existing liabilities should a member state quit the organization
- » An automatic guarantee is applied to new investments and financing contracts made by shareholder railways²

Eurofima's membership guarantee scheme has never been investigated formally by the EU. However, given that any EU rulings would not be applied retroactively, debts would not be affected.

Eurofima membership is largely comprised of highly rated countries

As at the end of September 2010, only 4 of the 25 member states were rated non-investment grade by Moody's, thereby underscoring Eurofima's creditworthiness (table 1). In addition, 13 were rated Aa or higher. However, over the past ten years, the increase in the number of countries that have signed and ratified the convention has resulted in a greater number of members with ratings of A or lower.

Although Eurofima is committed to increasing its membership, particularly among countries from central and eastern Europe, the organization is not obliged to lend to new members; rather, it assesses each application on a case-by-case basis. In addition, to have representatives on the board of directors, a member state needs to have attained a participation of at least 2% in Eurofima's share capital. With the downgrade of Greece by Moody's to non-investment grade on 14 June 2010, Eurofima's lending to non-investment-grade participants increased to 5% of the loan book, from less than 1% in previous years. However, Moody's considers this change to be manageable, especially in light of promptly adopted measures to reduce leverage to non-investment grade countries and strengthen capitalisation and liquidity ratios, which have already been realised in 2009 and mid-year 2010 accounts.

Privatizations have not led to increased credit risk as government guarantees continue to apply

Eurofima's objective is to obtain the lowest financing cost possible for the acquisition of the railroad rolling stock on behalf of its shareholders, or for other railways when a member state acts as guarantor. If a shareholder is a public limited company, its member state must guarantee the equipment financing contract. Although these guarantees are self-executory (i.e. they can operate on a stand-alone basis), they cannot be unilaterally disposed by Eurofima and are intended to be a mutual undertaking with the relevant government.

Over the past few years, Eurofima has developed a clear and workable procedure for dealing with the privatization of shareholders. Privatized railways may remain shareholders of Eurofima, provided their governments continue to guarantee their obligations to the organization and remain signatories to the convention. Privatization does not affect the existing guarantees for outstanding obligations.

¹ Article 13 of the Convention

² Article 5 of the Convention

TABLE 1

Ownership Structure (as of 30 September 2010)			
Shareholders	Abbreviations	Rating Of Country*	Equity Stake
Deutsche Bahn AG	DB AG	Aaa	22.60
French National Railways	SNCF	Aaa	22.60
Ferrovie dello Stato S.p.A.	FS	Aa2	13.50
SNCB Holding	SNCB	Aa1	9.80
NV Nederlandse Spoorwegen	NS	Aaa	5.80
RENFE Operadora	RENFE	Aa1	5.22
Swiss Federal Railways	SBB	Aaa	5.00
Železnice Srbije	ŽS	NR	2.24
Swedish State Railways	SJ	Aaa	2.00
Luxembourg National Railways	CFL	Aaa	2.00
ÖBB-Holding AG.	ÖBB	Aaa	2.00
Portuguese Railways	CP	A1	2.00
Hellenic Railways	OSE	Ba1	2.00
České dráhy, a.s	ČD	A1	1.00
Hungarian State Railways Ltd.	MÁV	Baa1 RUR down	0.70
Željeznična spoločnosť Slovensko, a.s.	ŽSSK	A1	0.50
HŽ Putnički prijevoz d.o.o.	HŽ	Baa3	0.20
Slovenske Železnice d.o.o	SŽ	Aa2	0.20
Bosnia and Herzegovina Railways	ŽBH	B2	0.20
Bulgarian State Railways Ltd.	BDZ	Baa3 Pos	0.20
Javno pretprijatie Makedonski Železnici-Infrastruktura (**)	MŽI	NR	0.08
Makedonski Železnici-Transport AD (**)	ZPCG	NR	0.02
Željeznički Prevoz Crne Gore A.D.	ŽCG	Ba3 Neg	0.06
Turkish State Railways	TCDD	Ba2	0.04
Danish State Railways	DSB	Aaa	0.02
Norwegian State Railways	NSB	Aaa	0.02

Note:* Sovereign Rating List as of 30 September 2010 - National Currency Government Bond Ratings.

** Macedonia split into two companies in 2007.

Financial Performance

Eurofima maintains a stable financial performance

Given that Eurofima does not seek to maximise profits, its profitability is low. Eurofima earns no net interest income on its equipment financing contracts refinanced by borrowings, and interest and principal receipts generally match debt service. Net earnings derive primarily from earnings on the investment portfolio and annual commissions paid by the borrowing railways on equipment financing contracts.

In 2009, Eurofima's net profit was up nearly 5% from 2008 at CHF50.8 million, reflecting (i) higher net interest income that more than offset a decline in revenues from other financial operations; and (ii) a 16% drop in operating costs in 2009, given some one-off items reported in 2008.

Eurofima has three key sources of revenue: net interest income, net commission income and net income from other financial operations. As stated above, net interest income was the main contributor to revenue growth, reaching CHF40.4 million in 2009 from CHF37.9 million in 2008. The key reasons for the increase were higher investment volumes combined with diminished funding costs. Net interest income is cautiously projected at CHF33.6 million in 2010.

Net commission income decreased to nearly CHF16 million in 2009, from CHF16.8 million in 2008; this source of revenue (traditionally very stable over time) is projected to stabilise in 2010 due to lower new volumes in financing contracts, before progressively growing toward CHF30 million in the course of the next three years. This will largely be the result of the recent update of Eurofima's commission structure, whereby commission rates applied to members vary according to the perceived creditworthiness of each country.

Net income from other financial operations declined to CHF2.1 million in 2009 from CHF2.6 million in 2008 and is expected to stabilise around these levels in the coming years. Eurofima closed all positions that could potentially present some risks in 2008-2009.

On the cost side, general administrative expenses fell 15.3% in 2009, returning in line with 2005-2006 levels. This is largely attributable to lower personnel costs and consulting fees related to the transition to the new accounting system. Operating costs are expected to stabilise going forward.

Eurofima's net profits for 2010 are cautiously projected at down 13% from the levels recorded in 2009. However, higher than expected results at the end of July should cast some optimism for Eurofima's financial performance in 2010.

Allocation of profits to reserves

The company's policy of allocating each year's profit is focused primarily on building capital resources by adding to its reserves, and only then paying dividends to shareholders (statutorily not exceeding 4% of paid-in capital). In 2009, no dividends were paid as a part of its new consolidation strategy, which is expected to be replicated in 2010. There are no restrictions on the use of the statutory reserve³, which was used in the past to increase paid-in capital. At the end of 2009, Eurofima's statutory reserves amounted to CHF528.4 million. Furthermore, the adoption of a new fund for general risks worth CHF274.7 million under the equity – which replaces all existing provisions, particularly for country and swap risks – provides greater flexibility, as it is not earmarked *a priori* for specific items.

Debt & Liquidity

Very high, although declining, financial exposure; strengthened liquidity ratios

In order to finance contracts extended to national railways, Eurofima raises funds in the international markets typically in the form of public bond issuances, under the debt issuance programme and through commercial paper. In light of Eurofima's dependence on the capital markets, availability of diversified funding sources is important to its funding strategy, and this is evident in its funding profile. Eurofima's assembly periodically sets annual borrowing limits (EUR4 billion, including short-term borrowing, for 2010).

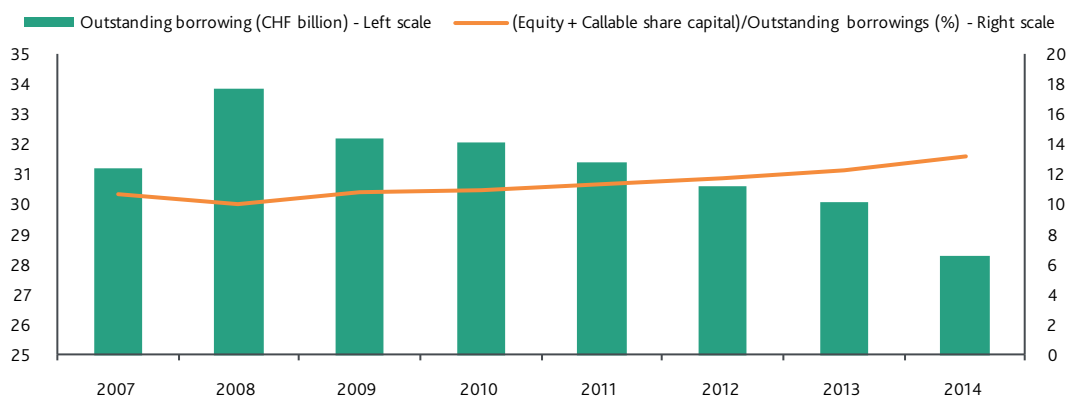
³ This includes ordinary plus guarantee reserves.

In 2009, Eurofima borrowed CHF4.3 billion (including commercial paper), largely drawn from the capital markets, compared with CHF8.7 billion in 2008. Such volumes have been in line with Eurofima's intention of adopting a more prudent funding policy in the context of partially distorted market conditions, especially at the beginning of 2009. Considering repayments for the year, net new borrowing was negative by nearly CHF1.4 billion; this is expected to remain negative going forward, leading to a progressive debt reduction towards CHF30 billion by year-end 2013, from CHF32.2 billion in 2009 (figure 1). Eurofima benefited from unchanged investor demand, as it was perceived as a secure port in time of crisis. Moody's notes a preference of short-to-medium term issuances over the long-term issuances more recently, which accommodate investors' preferences at the short end of the maturity scale.

Although US dollars and Swiss francs remain the main currencies, Eurofima aims for diversification – hence, the use of different currencies such as Australian dollar, Turkish lira, Mexican pesos or South African rand in recent years.

Closing out all positions, especially currency positions, has led the company to make fairly active use of derivatives (mainly swaps), usually to long maturities that hedge the long-term equipment financing on the balance sheet. Market-risk and credit-risk management guidelines governing derivatives activity are conventional, well administered and broadly effective. By accepting only highly rated financial counterparties, Eurofima significantly minimises its counterparty risk. The exposures are marked-to-market daily.

FIGURE 1
EUROFIMA's subscribed capital to total borrowings



Source: Eurofima

Eurofima's good liquidity would limit negative effects in the unlikely event of difficulties in accessing the market

Eurofima is totally dependent on the capital markets for funding and therefore has strict liquidity management regulations to ensure that the institution is not negatively affected by interruptions in capital markets. Eurofima has no funding gaps over the year. Lending and funding are fully matched and approximately 9.1% of the balance sheet consists of subscribed share capital, the fund for general risks and statutory reserves. Liquidity in excess of operating targets was CHF2.3 billion as of July 2010, up from CHF1.3 billion at year-end 2009. This should enable Eurofima to avoid capital and money markets for a period of approximately 12 months and still be able to continue its usual business of providing new financing for rolling stock. Liquidity coverage is planned to reach 11.1% by the end of 2010, from 8.5% at year-end 2009, trending upwards going forward.

In 2008, Eurofima updated its CP programme, increasing it to EUR2 billion from USD1 billion, with the aim of further improving its cost of funding. Since May 2009, the use of the CP programme has been rather contained, well below EUR400 million also in light of the company's preference of short term issuances.

Eurofima's investment policy is extremely conservative in that it allows investments in highly rated plain vanilla bonds only. Although this means that the yields of these reserves are not very high, the overall risk of the portfolio is relatively low. Eurofima has not deemed it necessary to obtain committed back-up lines given its liquidity management. Nonetheless, lines from banks have been approved verbally and funds would be available in the event of need.

No losses in Eurofima's loan portfolio

In Eurofima's nearly 54 years of existence, it has never suffered a loss as a result of not being able to collect on its loans.

In general, Eurofima finances up to 95% of the estimated total value of the contracted equipment. In the event that a railway fails to pay an installment when due, it must pay penalty interest of an amount determined at the time of payment failure. As of July 2010, no amount was overdue. If installments become three months overdue, the railway can be declared in default, the contract can be cancelled and the railway must then return the rolling stock to Eurofima. Eurofima has preferred creditor status, which means it is to be paid in priority and in full.

The portion of equipment-financing contracts being either non-investment grade or in unrated (by Moody's) countries peaked at 5% of the portfolio in June 2010 from less than 1% in the past years; this largely reflects Moody's downgrade of Greece sovereign rating on 14 June 2010. As a consequence Eurofima's coverage of capital exposure to non-investment grade countries dropped from a healthy 3.8x in 2009 to 0.5x in 2010. Moody's understands that Eurofima is committed to a rapid return to 2009 levels in the next few years.

Of note is the use of credit support annexes (CSA) since 2006 in order to hedge against swap counterparty risk. This mechanism provides for the posting of collateral by the swap counterparty once Eurofima's exposure exceeds a given threshold. Roughly 41% of swap exposures was collateralised in July 2010, compared to 29% in 2009 and 20% in 2008. All new swap contracts include CSA.

Adequate capitalisation

Eurofima's subscribed share capital is CHF2.6 billion, of which 20% is paid-in. The unpaid portion can be requested at any time. Eurofima is currently working with the member states to streamline its faculty to rapidly obtain the callable capital in case of need. Given Eurofima's low risk profile, Moody's views the company as being adequately capitalised and considers positively recent decisions to further strengthen Eurofima's capitalization ratios.

Shareholder railways, whose countries have Aaa or Aa ratings, represented around 91% of capital as at September 2010, while non-investment grade and non-rated countries represented less than 5% of capital. Equity plus callable share capital – which tend to remain extremely stable and oscillate within a very narrow band – together represented around 10.8% of total borrowings in 2009. Reportedly the ratio should increase toward 13% going forward.

Governance and Management

Eurofima's financial statements are provided annually on a timely basis and include a comprehensive set of economic and financial information, as well as extensive information regarding debt and contingent liabilities. These annual accounts are both approved by the General Assembly and audited by an independent auditing agent.

Internal control and supervision are carried out by (i) the General Assembly, which establishes borrowing caps, (ii) the Board of Directors, through quarterly meetings, and (iii) five internal auditors, through three yearly meetings.

Moody's views Eurofima's approach to asset/liability management positively, with the organization controlling financial risk by maintaining a close match between assets and liabilities. Refinancing, interest rate and foreign exchange risks are managed in closed positions, except for treasury operations where some mismatches occur.

Management has focused on operational risk for several years, given Eurofima's small organic size and the "mono-line" nature of its business. This has resulted in the establishment of administrative guidelines and controls to ensure uninterrupted management during crises. The controls also ensure that the staff is cross-trained and therefore able to assume other tasks should the need arise.

Rating History

Eurofima

Date	RATING
December 1994	Aaa
February 1998	P-1

Annual Statistics

Eurofima			
Cashflow Statement⁴			
CHF Millions	2007	2008	2009
Net FX amounts flows	(0.0)	(0.0)	0
Net Interest flows	31.4	30.0	53
Net Operational cash flows	(6.5)	(30.7)	(7)
Commission and fees received	17.8	17.3	17
Dividend paid	(20.7)	(20.7)	(20.7)
Net cash flow from operating activities	22.0	(4.2)	42.0
<i>Lending</i>			
Net flows from equipment financings	(1,929.1)	(2,863.0)	729
<i>Financial investments</i>			
Purchase of debt securities	(911.9)	(538.7)	(501)
Redemptions	999.3	504.6	197
Sales of debt securities	133.3	198.2	105
Net flows from placement with credit insitutions	(102.4)	(240.3)	370
Net flows from other financial	(65.8)	0.0	61
<i>Other items</i>			
Net movements in other assets	0.0	0.0	0
Net movements in fixed assets	0.0	0.0	0
Net cash flows from investing activities	(1,876.6)	(2,939.3)	960.1
Issues of new debt	7,805.7	8,385.3	4,236
Redemptions	(6,194.9)	(5,422.0)	(5,255)
Net flows from credit institutions and customers	(33.1)	63.5	(62)
Net cash flows from derivatives	464.4	(199.0)	467.6
Paid-in capital	0.0	0.0	0.0
Net cash flows from financing activities	2,042.0	2,827.9	(613.5)
Exchange rate difference	22.7	(109.4)	(7)
Others	0.8	3.6	(3)
Increase/decrease in cash and cash equivalents	210.9	(221.4)	379.1
Cash and cash equivalents at beginning of period	637.8	848.7	627.3
Cash and cash equivalents at end of period	848.7	627.3	1,006

⁴ Numbers are rounded to the first decimal point.

Moody's Related Research

Rating Methodologies:

- » [The Application of Joint Default Analysis to Regional and Local Governments, December 2008 \(99025\)](#)
- » [Regional and Local Governments Outside the US, May 2008 \(107844\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Report Number: 128023

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