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Update

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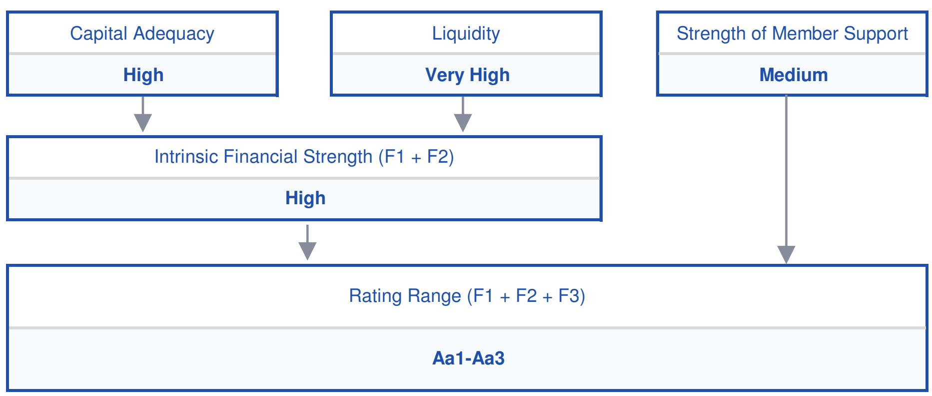
Eurofima – Aa2 Stable

Update following downgrade to Aa2 and change in outlook to stable

Summary

The credit profile of Eurofima is supported by its strong asset quality, demonstrated by the absence of credit losses since its inception in 1956. Furthermore, the organisation's risk management framework is prudent and the level of supervision under which it operates is adequate. Eurofima also benefits from very strong support from its shareholders, which is underpinned by a weighted median shareholder rating of Aa2. Those credits features are set against Eurofima's substantial leverage, the highest in our rated universe, and resulting limited callable capital coverage of the debt stock, which impacts strength of contractual support.

Exhibit 1
Eurofima's credit profile is determined by three factors



Source: Moody's Investors Service

Credit strengths

» Eurofima's strong asset quality given the absence of credit losses

» Eurofima's preferred creditor status

Credit challenges

» Eurofima's very high leverage relative to other MDBs

» Low callable capital relative to its debt obligations

Rating outlook

The stable outlook balances the very significant strengths in Eurofima's balance sheet against weaknesses which argue against an even higher rating. A strong capital and liquidity position balance a "Medium" assessment of members support. Very strong asset performance, without a single loss since its inception in 1956, which helps mitigate its substantial leverage. At the end of 2017, 64% of loans outstanding were rated Aa or higher. Eurofima's liquidity position benefits from back-to-back asset/liability management and diversified sources of funding. Notably, total liquid assets at the end of 2017 accounted for around 24% of total borrowing.

Looking forward, the stable outlook reflects our expectation that the credit quality of Eurofima's borrowers will not materially worsen as the institution's lending operations adapt to the liberalization of the railway sector under the 4th railway package and the introduction of non-sovereign shareholders. In the short term, lending to regions in those markets which are already largely liberalized, such as in Germany (Aaa stable), could improve asset quality. Over the longer term, Eurofima's commitment to engage with high quality guarantors will help to ensure continuity in with its prudent lending strategy. The stable outlook is also supported by Eurofima's ongoing de-risking strategy, which will continue to reduce its very high leverage and strengthen its liquidity position.

Factors that could lead to an upgrade

Upward pressure on the rating would arise from an acceleration of the strategy to bring Eurofima's leverage and capital adequacy metrics closer to peers. Furthermore, a renewed strengthening of member support, including the reinstatement across the balance sheet of protections consistent with those provided by Article 26, would also be credit positive.

Factors that could lead to a downgrade

Conversely, downward rating pressure would likely develop in the event of a pronounced and significant deterioration in asset quality. In particular, the incorporation of a significant share of lower rated or unrated borrowers which impacts on our assessment of Capital Adequacy, through a deterioration in the Weighted Average Borrower Rating, would be credit negative, especially in light of Eurofima's very high leverage. Such an outcome could also lead us to equalise the ratings of pre- and post-1 January 2018 at the level of the latter, if we were to conclude that its assumption of reasonably high correlation between the two sets of assets was no longer valid. More broadly, we could equalise the two ratings at the level of the lower if we were to conclude that assumptions regarding likely recoveries in default by holders of outstanding debt instruments issued prior to 1 January 2018, or regarding the robustness of the operational or legal arrangements put in place to protect those bondholders, were no longer valid. Finally, a deterioration in shareholder's quality would be considered credit negative.

Key indicators

Exhibit 2

Eurofima	2011	2012	2013	2014	2015	2016	2017
Total Assets (USD million)	36,526	34,157	30,934	26,376	22,983	20,571	20,401
Return on Average Assets (%)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Usable Equity/Gross Loans Outstanding + Equity Operations (%) [1]	5.8	6.8	7.4	8.7	10.3	11.2	11.9
Gross NPLs/Gross Loans Outstanding (%) [2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ST Debt + CMLTD/Liquid Assets (%) [3]	83.9	66.5	88.5	88.3	95.8	81.3	66.3
Total Debt/Discounted Callable Capital (%) [4]	1,824.9	1,910.2	1,668.5	1,268.9	1,090.3	975.2	934.7

[1] Usable equity is total shareholder's equity and excludes callable capital

[2] Non performing loans

[3] Short-term debt and currently-maturing long-term debt

[4] Callable capital pledged by members rated Baa3 or higher, discounted by Moody's 30-year expected loss rates associated with ratings

Sources: Eurofima, Moody's Investors Service

Detailed credit considerations

On 12 October 2018, we downgraded Eurofima's ratings by one notch to Aa2, confirmed the Aa1 rating for bonds issued prior to 1 January 2018 and assigned a stable outlook, concluding the review for downgrade that was initiated on 18 May 2018. The decision reflects our conclusion that the ratification of changes to Eurofima's statutes to anticipate the further liberalization of the passenger railway market will weaken member support for the issuer. At the same time, we expect that the arrangements put in place to ensure that bondholders of securities issued prior to 1 January 2018 continue to benefit from the Subsidiary Shareholder Guarantee ("SSG") are sufficiently robust as to warrant retaining the Aa1 rating. The decision to assign a stable outlook balances the very significant strengths in Eurofima's balance sheet, including very strong asset performance, against weaknesses such as high leverage which argue against an even higher rating.

We assess the **capital adequacy** of Eurofima as "High", reflected in the strength of its asset quality, which helps to mitigate its substantial leverage. Going forward, we expect that Eurofima will continue to reduce the size of its balance sheet, although the extent to which it can internally deleverage is limited given its low capacity to generate profit – a typical feature of Multilateral Development Banks (MDBs). At the end of 2017, 64% of loans outstanding were rated Aa or higher (unchanged from a year earlier). Supported by its preferred creditor status, collateralisation of loans by rolling stock and its exposure exclusively to sovereigns, Eurofima has not experienced a loss in its 62-year history.

We assess the **liquidity** position of Eurofima as "Very High", which reflects its prudent liquidity policy, strict back-to-back asset liability management of its core lending businesses and diversified sources of funding. Liquidity management policies for Eurofima are very strict given its reliance upon market funding. Liquid assets encompass cash and cash equivalents as well as financial instruments and placement in highly rated institutions. At the end of 2017, its total liquid assets amounted to CHF 4.3 billion, accounting for 24.2% of total borrowing (CHF 17.6 billion, book value), a ratio higher than the 19.7% it recorded in 2016.

Eurofima scores "Medium" in our assessment of **strength of member support**. This score balances the very limited size of its contractual support relative to its debt obligations against the moderate willingness of its shareholders to provide support in case of need. At the same time, the very high ability of Eurofima's shareholders to support is underpinned by a weighted median shareholder rating of Aa2.

The very limited size of its contractual support relative to its debt obligations is reflected in a debt-to-discounted callable capital ratio of 934.7% (a consequence of its high leverage and hence a key credit challenge). Furthermore, we believe that extraordinary support is constrained by the multiple and sizable obligations of its largest shareholders towards other MDBs, that might affect priority of support in a stressed scenario with several MDBs simultaneously in need of assistance.

Recent developments

Discontinuation of subsidy shareholder guarantee under Eurofima's new Statutes weighs on our assessment of strength of member support

Eurofima's recently announced the conclusion of its strategic review (Project Horizon) to respond to the changing regulatory landscape in order to focus on opening the entity to public authorities and private rail operators under certain conditions. The press release issued on 8 May 2018 outlined a proposed amendment to Eurofima's Statutes to help facilitate these changes which included the discontinuation of the subsidiary shareholder guarantee, material to our assessment of strength of member support.

In its press release published on 9 October 2018 Eurofima announced that its internal review process has been finalized and the proposed amendments to the statutes will now take effect, with the discontinuation of the subsidiary shareholder guarantee. The final implementation of these statutory changes has prompted us to downgrade Eurofima's issuer rating to Aa2 from Aa1 to reflect the reduced strength of member support and to change the outlook to stable. The latter is driven by our confidence in Eurofima maintaining its prudent approach to lending, as mirrored in the strong asset performance of its current portfolio. Following the global financial crisis, Eurofima started pursuing a gradual but consistent de-leveraging and de-risking strategy, which resulted in a substantial narrowing of the organization's balance sheet and limitation of its non-investment grade (NIG) exposure, which stood at around at 4% of total portfolio as of end-2017, down from around 12% in 2013. Since its establishment in 1956, Eurofima has never suffered a loss.

At the same time, Eurofima took measures to ensure the subsidiary shareholder guarantee continues for bonds issued prior to 1 January 2018, which drove our decision to confirm senior unsecured foreign currency rating for bonds issued prior to this date at Aa1 stable. The decision to lower the rating of the senior unsecured foreign currency MTN rating to (P)Aa2 reflects our view that future draw-downs under the programme would no longer entitle bondholders to benefit from the Article 26 guarantee. As such, any future drawdowns under the programme would be assigned a debt rating of Aa2.

Eurofima's substantial deleveraging continued in 2017

Eurofima has continued its efforts to decrease its substantial leverage and to reduce the credit risk, resulting in a smaller balance sheet size. Debt as a percentage of usable equity has fallen to 1,081% in 2017 from 1,140% in 2016, driven primarily by decreasing debt (-4.1% to CHF 17.6 billion) and to lesser extent by higher usable equity (+1.1% to CHF 1.6 billion). As a result, the balance sheet has been reduced further to CHF 19.9 billion in 2017 from CHF 20.9 billion in 2016 (a 4.8% decrease), and is much smaller compared to 2008 when the total balance sheet stood at CHF 40.4 billion.

Nevertheless, despite the decreasing trend, Eurofima's debt-to-usable equity ratio at 1,081% in 2017 remains by far the highest in our rating universe, significantly above the Aa-rated median of around 140% and Aaa-rated median of around 280%.

In tandem with a declining loan portfolio, net profits have fallen further to CHF 16.7 billion in 2017 from CHF 21.0 billion a year ago and an average of CHF 38.2 billion between 2009 and 2015. We expect profits to rise gradually in the medium term as global interest rates increase, although, given Eurofima's mandate to provide the lowest financing cost possible for its shareholders and its strict internal investment rules, its capacity to increase usable equity through higher earnings will remain limited.

Asset quality remained strong in 2017

The overall asset quality of Eurofima remains very high. The entity did not record any impairments or early indications of impairments in 2017, extending its track record of no credit losses or overdue payments to 62 years. In 2017, Eurofima concluded five loan contracts with two shareholders: Switzerland (Aaa stable) in the amount of CHF 283 million and Belgium (Aa3 stable) in the amount of CHF 62 million. As a result, the proportion of loans to shareholders rated Aa and higher remained substantial at 64% of loans outstanding, in line with a year earlier. At the same time, loans to non-investment grade member countries decreased further to 3.8% of total loans at the end of 2017 from 5.2% in 2016 and an average of 10.7% between 2012 and 2014.

In 2017, Eurofima's stock of liquid assets increased for the first time since 2014, strengthening its shock absorption capacity. This expansion was driven by a change in its derivative contract framework which led to received cash collaterals from two-way credit support annex collateral agreements. As a result, the stock of liquid assets increased by 17.6% to CHF 4.2 billion in 2017 from CHF 3.6 billion a year ago. However, reflecting this policy change, Eurofima's short term debt also increased - collateral due to credit institutions and customers stood at CHF 516 million, a notable share of the total CHF 17.6 billion borrowings as of end-2017. That said, the total amount of borrowings decreased in 2017 by over 4%.

In March 2017, Eurofima issued its inaugural Socially Responsible Investment through an “Environmentally Friendly Railway Bond” in the form of a 10-year $100 million private placement. Apart from this issuance, the entity continued its two-pillar borrowing strategy, based on euro and dollar benchmark issuances, as well as its strategic commitment to Australian dollar and Swiss franc bond markets. Eurofima raised CHF 725 million in the debt capital markets and CHF 5.1 billion in the money market in 2017.

The capacity of shareholders to extend support remains very high, as highlighted by the entity's weighted median shareholder rating of Aa2 in 2017, one of the highest in our rating universe. Although the weighted median shareholder rating remained unchanged from 2016, there has been a strengthening of some shareholders' credit profiles compared to end-2016, reflected in rating upgrades of Greece (B3 positive) (from Caa3 stable), Serbia (Ba3 stable) (from B1 positive) and Slovenia (Baa1 stable) (upgrade from Baa3 positive).

Rating methodology and scorecard factors

Rating Factors - Eurofima

Rating Factors	Factor Weight	Factor Score
Factor 1: Capital Adequacy	60%	High
Factor 2: Liquidity	40%	Very High
Intrinsic Financial Strength (F1 + F2)	**Preliminary Rating Range**	**High**
Factor 3: Strength of Member Support	+3, +2, +1, 0 notches	Medium
Rating Range (F1 + F2 + F3)		**Aa1-Aa3**
Assigned Rating		**Aa2**

Note: While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.

For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Footnotes:

(1) Rating Range: Factor 1, Capital Adequacy, and Factor 2, Liquidity, combine according to the weights indicated into a construct we designate as Intrinsic Financial Strength (IFS). A notching system combines IFS and Factor 3, Strength of Member Support.

(2) 5 Ranking Categories: Very High, High, Medium, Low, Very Low.

Moody's related publications

- **Rating Action:** Moody's downgrades Eurofima's ratings to Aa2 and assigns stable outlook, 12 October 2018
- **Rating Action:** Moody's places Eurofima's Aa1 ratings under review for downgrade, 18 May 2018
- **Issuer in-Depth**: Eurofima – Aa1 stable: Annual credit analysis, 6 October 2017
- **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 17 September 2018

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