Research Update:

EUROFIMA 'AA/A-1+' Ratings Affirmed; Outlook Remains Negative On Weakening Capital Position

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Overview

- During the past 12 months, EUROFIMA European Co. for the Financing of Railroad Rolling Stock reduced its reliance on its commercial paper and contracted new liquidity facilities, which structurally improved its liquidity ratios.
- However, EUROFIMA's risk-adjusted capital ratio (RAC) as of December 2022 registered further declines, partly due to weaker equity generation and slightly increased loan portfolio concentration.
- We therefore affirmed our 'AA/A-1+' long- and short-term issuer credit ratings on EUROFIMA.
- The outlook remains negative, reflecting our expectation that EUROFIMA's RAC ratio might decline or remain stagnant due to its high loan portfolio concentration or insufficient equity generation over the next 12-24 months.

Rating Action

On June 26, 2023, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on Switzerland-based EUROFIMA European Co. for the Financing of Railroad Rolling Stock. The outlook remains negative.

Rationale

EUROFIMA has structurally improved its liquidity ratios by reducing its reliance on short-term commercial paper and contracting liquidity facilities with two Switzerland-based banks. Nevertheless, EUROFIMA's capital position has weakened over the past few years. Our estimated risk-adjusted capital (RAC) after adjustments decreased further to 9.3% in 2022 from 9.5% as of year-end 2021, and 9.8% as of year-end 2020. While nominal loan growth decreased by 3% in 2022, risk-weighted assets increased, which was not offset by EUROFIMA's equity generation. Our largest adjustment to the RAC calculation relates to sovereign single-name concentration, which captures the very high concentration of EUROFIMA's lending book. While EUROFIMA could register an improvement in its RAC ratio--consistent with a strong capital adequacy assessment on the back of its diversification efforts as it reactivates lending with other members--the negative outlook reflects risks that could continue to constrain the capital ratio.

EUROFIMA's flat loan portfolio over the past several years reflects its gradually weakened role, as much of its lending is highly exposed to direct price competition from commercial banks and other multilateral lending institutions (MLIs). Some larger shareholders finance themselves through established bond programs or with other banks, and smaller shareholders have not been able to borrow due to risk considerations and capital constraints. Five borrowers have underpinned EUROFIMA's niche mandate--namely the state-owned railways of Spain, Austria, Belgium, Italy, and Switzerland. These accounted for about 91% of the company's total equipment financing contracts on May 31, 2023.

EUROFIMA projects that its portfolio will remain flat during 2023 due to the currently uncertain and volatile environment, high inflationary pressure, and rising interest rates, which continued to add uncertainty to rail investment plans. During 2022 and the first half of 2023, EUROFIMA negotiated a financing framework to reactivate lending with some of the existing shareholders and will continue to focus on such transactions going forward. This could provide some additional diversification and support EUROFIMA's capital assessment

Our strong enterprise risk profile assessment factors in our view of EUROFIMA's management and governance and the track record of borrowing members affording EUROFIMA preferred creditor treatment (PCT). Our PCT assessment considers, on a country-by-country basis, whether over the past 10 years a borrowing country has been in arrears; that is, either interest or principal overdue by 180 days or more. Based on our definition of arrears, no country to which EUROFIMA lends has been in arrears over this period. As such, we consider EUROFIMA's PCT assessment to be very strong and all its borrowing members qualify in the strongest PCT category.

We assess EUROFIMA's governance and management expertise as strong because of its well-balanced shareholding structure, its members' high ranking in World Bank governance indicators when compared with other MLIs, and its conservative risk management policies. We also highlight that the average rating of its lending portfolio is one of the highest among our rated MLIs.

Our rating on EUROFIMA benefits from the institution's status as a preferred creditor, given that all its loans are backed by individual sovereign guarantees, although the percentage of the loan book that is cross guaranteed (that is, backed by all of EUROFIMA's shareholders) has declined to an estimated 45% at present from 100% in 2018.

EUROFIMA's six-month liquidity ratio improved to 1.44x and its 12-month ratio to 1.27x, as of May 31, 2023, up from 1.10x and 1.15x, respectively, one year ago. Additionally, as of December 2022, EUROFIMA's liquid assets had increased to €5.0 billion from €4.7 billion at year-end 2021. Our liquidity ratios indicate that the company will meet its financial obligations over one year, supported by the absence of scheduled loan disbursements over that time.

EUROFIMA's funding investor base is well diversified, and it regularly issues predominantly on the euro and U.S. dollar markets. We believe the company does not overly rely on one market and regularly taps into the capital markets. EUROFIMA's one-year funding gap, calculated as maturing assets divided by maturing liabilities, was 1.26x at the end of May 2023.

On a stand-alone basis, we base our ratings on EUROFIMA on its strong enterprise risk profile and very strong financial profile. Combining these assessments, we derive a stand-alone credit profile (SACP) of 'aa-'. The ratings on EUROFIMA include potential extraordinary support from shareholders rated above the 'aa-' SACP. Although EUROFIMA has total callable capital of Swiss franc (CHF) 2,080 million, we incorporate CHF1,524 million of eligible callable capital into our assessment and arrive at the enhanced financial risk profile assessment of extremely strong, which leads us to apply a one-notch uplift to the rating. Our adequate policy importance assessment leads us to cap the uplift at one notch.

Outlook

The negative outlook reflects our expectation that EUROFIMA's RAC ratio might decline or remain stagnant due to its high loan portfolio concentration or insufficient equity generation over the next 12-24 months.

Downside scenario

We could lower the ratings on EUROFIMA in the next 12-24 months if the adjusted RAC ratio deteriorates further, for instance, as a result of increased concentration in the loan portfolio or weaker equity generation, or if institution's relevance diminishes demonstrated by a significant reduction of new loan disbursements.

Upside scenario

We could revise the outlook to stable if we observe that the concentration of the loan portfolio is reducing or if retained earnings or a capital injection relieve pressure on the adjusted capital ratio. This assumes that EUROFIMA will maintain a solid liquidity position and asset quality, as well as preserve its importance on the market of operation.

Ratings Score Snapshot

Issuer credit rating: AA/Negative/A-1+

Stand-alone credit profile: aa-

Enterprise risk profile: Strong

- Policy importance: Adequate
- Governance and management: Strong

Financial risk profile: Very Strong

- Capital adequacy: Strong
- Funding and liquidity: Very Strong

Extraordinary support: +1

Callable capital: +1

Group support: 0

Holistic approach: 0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology , Jan. 31, 2022

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology , July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Ratings List

Ratings Affirmed	
EUROFIMA European Co. for the Financing of Railroad Rolling Stock	
Issuer Credit Rating	
Foreign Currency	AA/Negative/A-1+
EUROFIMA European Co. for the Financing of Railroad Rolling Stock	
Senior Unsecured	AA
Commercial Paper	A-1+