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Research Update:

EUROFIMA 'AA+/A-1+' Ratings Affirmed On Revised Criteria; Outlook Negative

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Overview

- Following a review of EUROFIMA European Co. for the Financing of Railroad Rolling Stock under our revised criteria for multilateral lending institutions, we are affirming our 'AA+/A-1+' long- and short-term issuer credit ratings on the company and removing them from under criteria observation.
- Recent amendments of EUROFIMA's statutes allow the company to attract new shareholders as borrowers. Although EUROFIMA is an experienced railway financing organization, challenges remain as it has limited track record of engaging with the new targeted segment of the market.
- The negative outlook reflects the risk of a two-notch downgrade in the next 12 months if EUROFIMA cannot shore up its policy importance by implementing its business plan. It plans to attract a significant number of new shareholders and extend loans to them, such that around 15% of its loan book by 2020 would be allocated to these new exposures, significantly moderating the overall decline in the portfolio.

Rating Action

On Feb. 27, 2019, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term foreign currency issuer credit ratings on EUROFIMA European Co. for the Financing of Railroad Rolling Stock. The outlook is negative.

The ratings are no longer under criteria observation, where we placed them on Dec. 14, 2018, following publication of our revised multilateral lending institution (MLI) criteria.

We also affirmed our 'AA+' issue rating on EUROFIMA's senior unsecured notes, and our 'A-1+' rating on its commercial paper.

Rationale

We affirmed our ratings on EUROFIMA based on our assessment of its strong enterprise risk profile and extremely strong financial risk profile after extraordinary shareholder support. We outline these factors in our revised criteria, "Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Dec. 14, 2018. EUROFIMA's stand-alone credit profile is 'aa'. Our final assessment of the rating includes one notch for extraordinary support, after factoring eligible callable capital from members rated above 'AA'.

Against the backdrop of recent changes in the market where EUROFIMA operates, particularly the 2016 implementation of the EU's fourth railway package, EUROFIMA began a process to align its statutes to allow it to provide financing to new market participants. The EU's fourth railway package is a directive that seeks to increase competition in the passenger railway market and secure financing for railway rolling stock to new market entrants.

As a result, on June 5, 2018, EUROFIMA's General Assembly approved amendments of its statutes to open up to new shareholders and borrowers (a borrower must also be a shareholder unless other shareholders issue a guarantee in favor of the borrower).

In our view, if EUROFIMA successfully implements its statutes, it could see a long-term expansion in its membership and client base. Ultimately, this will enhance the institution's role and public policy mandate. However, if EUROFIMA is unsuccessful in attracting a significant number of new members, its loan book could reduce by more than a quarter of the current amount, indicating a weaker policy importance. Our overall assessment also assumes that no major shareholder will leave the company.

In amending EUROFIMA's statutes, the subsidiary shareholder guarantee (SSG) was partially removed. The SSG is a cross-guarantee scheme under which, if a defaulting railway's member state does not honor its obligations, and its obligations exceed EUROFIMA's guarantee reserve of Swiss franc (CHF) 1 billion as of December 2017, other shareholders guarantee the fulfilment of these obligation.

Before the amendments, the SSG covered the performance of all equipment finance contracts; after implementing the amended statutes, the SSG will only cover the performance of those loans provided by EUROFIMA before Jan. 1, 2018 (existing loans). The SSG will therefore cease to exist when all existing loans mature. Although this could differentiate between existing and new bondholders, in our view, the different layers of protection and the extraordinary shareholder support from callable capital continue to support the rating.

Moreover, we anticipate that shareholders will continue to forgo dividend payments, so that EUROFIMA will maintain its high earnings retention. Our analysis takes into account that different layers of protection would still be available for new equipment finance contracts, and would remain unchanged for the existing lending portfolio.

Our strong business profile assessment considers our view of EUROFIMA's governance, role, and public policy mandate. It also incorporates the track record of borrowing members affording EUROFIMA preferred creditor treatment (PCT).

EUROFIMA is a Switzerland-based specialized supranational is a joint-stock company created in 1956 by an international treaty. Owned mostly by the national railways of 25 continental European countries, the company finances railway equipment for its members. As of December 2017, railways based in countries rated 'AAA' held roughly 37% of EUROFIMA shares and callable capital, down from 62% at end-2011.

Following the onset of the global financial crisis in 2008, EUROFIMA introduced measures to shrink its balance sheet and build capital internally. In the financial year ending December 2010, the loan book stood at CHF26.4 billion; this shrank to CHF13.7 billion in FY2017. The weighted-average asset quality of the loan book was 'A+' at the end of 2017, which was significantly higher than its rated peers.

EUROFIMA has traditionally enjoyed preferred creditor treatment, and we expect it will continue to benefit from it. The company has never experienced a loan loss or required immediate payment under a government guarantee.

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, having either interest or principal that is overdue by 180 days or more. Based on this 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.

Even after the SSG ceases to exist, EUROFIMA will benefit from other layers of protection. These differentiate it from other MLIs we rate. In particular, physical collateral is attached to the rolling stock. The stock's estimated fair value provided a coverage ratio of 66% for the outstanding amount of the equipment finance contracts in December 2017.

In our opinion, EUROFIMA rests on sound governance principles and the rigorous application of accounting standards. We do not foresee any changes to the company's risk management, and we expect policies around the implementation of the amendments to remain robust.

EUROFIMA's financial risk profile considers the strengths in its capital adequacy and funding and liquidity.

Our view of a very strong financial profile before extraordinary shareholder support takes into consideration our view that the estimated risk-adjusted capital (RAC) ratio after adjustments for 2018-2020 will remain 10%-15%. Under our revised methodology, as of December 2017, the RAC ratio after MLI-specific adjustments is 10%.

The largest adjustment is on sovereign single name concentration, which under our revised methodology disregards exposure to treasury assets and as such captures more accurately the high concentration of EUROFIMA's lending book--five borrowers accounted for 86% of its portfolio as of December 2017.

We currently expect funding and liquidity ratios for EUROFIMA to remain broadly unchanged as the company finances rolling stock based on matched funding principles, which we view favorably. EUROFIMA has steadily strengthened its liquidity over the past few years. Liquid assets as of year-end 2017 increased to 21% of total adjusted assets from 17% the year before.

Our liquidity ratio assumes that a company would not have access to the capital markets due to stressed market conditions. Even in this case, we believe EUROFIMA would be able to meet its financial obligations over a two-year period, supported by the absence of scheduled loan disbursements over that time.

EUROFIMA's one-year funding gap, calculated as maturing assets divided by maturing liabilities, in December 2017 was 1.4x; the ratio is cumulative and based on scheduled receipts and payments.

EUROFIMA resumed its activity in the capital markets in the last quarter of 2018. It issued its first green bond for €500 million, with a five-year maturity, in December. This issuance followed the bonds issued in November 2018; a new A$100 million Kangaroo bond and a US$500 million floating-rate note.

Outlook

The negative outlook reflects the risk of a two-notch downgrade in the next 12 months if EUROFIMA cannot shore up its policy importance by implementing its business plan. It plans to attract a significant number of new shareholders and extend loans to them, such that around 15% of its portfolio by 2020 would be allocated to these new exposures, significantly moderating the overall decline in the portfolio.

We could revise the outlook to stable if EUROFIMA broadens its shareholder base and offsets the reduction in borrowings by historical shareholders while maintaining high asset quality and strong market access.

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, Dec. 14, 2018
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Supranationals Special Edition, Oct. 11, 2018

Ratings List

Ratings Affirmed

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44)

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