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Inter-American Investment Corporation

Overview

The Inter-American Investment Corporation (IIC) was established in 1986 as part of the Inter-American Development Bank Group (IDB) Group, which also includes the Inter-American Development Bank (IDB) and the Multilateral Investment Fund (MIF). The IIC's Aa2 rating incorporates the implicit financial support that the Corporation derives from the IDB. The Corporation began operations in 1989 with the mission to promote the economic development of its Latin American and Caribbean member countries by financing primarily small-and medium-size private enterprises.

The IIC, together with private investors, accomplishes its developmental mission by making loan and equity investments where sufficient private capital is not otherwise available on reasonable terms, mobilizing additional project funding from other investors and lenders through co-financing or loan syndication, and by providing financial and technical advisory services. The Corporation receives its share capital from its member countries and limits operational activity to its 26 Latin American and Caribbean member countries. The IIC loans are made without the benefit of a sovereign guarantee though the mission of the Corporation has strong support from major non-borrowing members.

In recent years, organizational changes carried out jointly by management and the Board of Executive Directors have been directed to overcome the financial difficulties that the Corporation faced during the 2001-2003 period. Management has placed special emphasis on the need to overhaul credit policies, to improve the quality of the loan and investment portfolios and to strengthen the balance sheet. In Moody's view, the improvement observed to date is clear indication of the commitment of both management and the shareholders to make the adjustments required to restore conditions supportive of a stable outlook.

To the extent that the IIC strives to fulfill its developmental role, the overall quality of its portfolio will continue to incorporate a high-risk component derived from its credit profile. This condition may lead to somewhat sharp and sudden increases in overall credit risk, particularly during periods of financial stress in the region. While the development mandate of the IIC introduces an element of potential conflict with the objective of financial self-sustainability, its recent track record indicates that the Corporation has been able to address this problem by means of improved financial and credit management.

Capital Adequacy

The Corporation was established with initial paid-in capital of \$200 million. The IIC can issue callable capital but has never elected to do so. In 1999, the member countries agreed to a \$500 million capital increase to be paid in eight yearly installments of around \$62 million each, beginning in the last quarter of 2000. As of December 2005, over \$300 million of the installments had been paid, representing 82% of the installments due. Argentina, Haiti, Paraguay, and Suriname have made initial capital contribution payments. To date, forty of the forty-three member countries have made capital payments.

The Corporation's capital was \$500.9 million in 2005, as compared with \$443.8 million in 2004. The United States is the largest shareholder, contributing 25% of the total subscribed capital, while Argentina and Brazil each own 11%. Korea, joined as a new shareholder in 2005 and paid in full its capital contribution. Together the ten largest shareholders account for over 75% of subscribed capital.

Since the IIC has not issued callable capital, the Corporation's high capitalization level is an integral element supporting its rating as it enhances the financial capabilities to withstand shocks, as observed in previous years. As of year-end 2005, paid in capital plus accumulated earnings and loss reserves amounted to 103% of total gross loans and equity investments. This figure compares with a ratio of 107% for 2004 and 69% prior to the 1999 capital increase agreement.

Asset Composition And Quality

The Corporation makes loan and equity investments to private-sector companies domiciled in the 26 Latin American and Caribbean member countries. As of December 31, 2005, the countries with the largest aggregate credit exposure to the Corporation were Colombia (18.0%), Brazil (16.7%), Chile (8.6%), and Mexico (5.7%). Compared to the previous year, the most important change reported in the Corporation's credit exposures was related to Colombia's change in ranking as it became the IIC's largest exposure, while Argentina's exposure continued to decline. At year-end 2004, the countries with the largest credit exposure were Brazil (14.4%), Chile (9.9%), and Mexico (7.7%).

In 2005, approvals and disbursements reached record levels. Last year, the Corporation approved \$341.7 million that were allocated to 37 new projects in 15 countries in addition to 3 regional projects. These numbers compare with \$163.6 million in 31 project operations in 15 member countries and two projects with regional coverage during 2004. In Moody's opinion, the significant increase reported in the approvals volume during 2005 reflects the presence of more efficient and streamlined origination, approval and disbursement processes. The presence of a larger number of projects also reflects a newfound focus on smaller loan sizes, as well as changes in the product mix offered by the Corporation which has included trade finance and working capital loans of shorter maturities.

Total investments, including loans, equities and mortgage-backed securities net of allowances for losses amounted to \$454 million in 2005 up from \$367 million in 2004 and \$332 million in 2003. Management has indicated that during 2006 the IIC will continue to explore new investment opportunities including loans in local currency, credit guarantees, and quasi-equity operations that would involve minority interests.

Allowances for losses are established through periodic charges to income in the form of a provision for losses on investments. Investments written off, as well as any subsequent recoveries, are recorded through the allowance account. Last year's provision charges implicitly reflected the continued improvement in IIC's portfolio of loans and equity investments. During 2005, provisions for losses resulted in a release of \$42 thousand dollars, a shift with respect to the previous year since an expense charge of \$3.3 million was reported during 2004.

The Corporation registered a \$17.9 million write-off of its equity investment position during 2005 as it determined that certain equity investments had met the conditions for impairment i.e., fair value below 50% of its cost and decline considered to be other-than-temporary; additionally \$3.7 million were written off from its loan portfolio. These adjustments reflect an ongoing process carried by management and supported by provisions made in previous years, that has allowed the Corporation's to present a balance sheet that better reflects the underlying quality of its assets.

Improved asset quality in the Corporation's loan portfolio is confirmed by the decline reported in the ratio of past-due loans to total loans which stood at 5.5% in 2005 compared with 9.5% in 2004 and 13.1% in 2003 – at its peak the NPL ratio was 16.7% during 2002. Loans on non-accrual¹ have declined as well, falling to 12% in 2005 of total loans outstanding from nearly 20% in 2004 and 30% in 2001. This reduction was driven by a combination of factors that included (i) improved asset quality, (ii) write-offs, and (iii) a \$90 million increase in loans outstanding. It is important to

1. Loans on non-accrual are defined as those which the Corporation believes there is a strong probability of not receiving full payment

note that while this ratio is higher than the one observed in most multilateral institutions, some 50% of loans reported as non-accrual are performing, yet, the Corporation has maintained the practice of keeping loans on a non-accrual status for a one-year probationary period even after they begin performing.

During 2005, the IIC maintained loan-loss reserves equal to 200% of past-due loans and 93% of total non-accruals. During 2004, the equivalent ratios stood at 140% and 71%, respectively. According to the guidelines established by the IIC's risk committee, 84% of outstanding loans and equity investments are classified as satisfactory compared with 73% in 2004, while 16% were considered to be problematic compared with 27% in 2004.²

Borrowings, Long-Term Debt, And Liquidity

The Corporation's outstanding borrowings consist of term and revolving-credit facilities with the IDB, Caja Madrid and the Shinkin Central Bank. Also, in December 2005, the Corporation issued a local currency-denominated bond of some \$66 million in the Colombian market (see box below).

Borrowings under the IDB facility are due 15 years after the respective disbursement and are renewable – the Corporation has never tapped the IDB facility. Last year the Corporation renewed until November 2010 the loan agreement that allows IIC to borrow up to \$300 million from the IDB. The Caja's revolving credit facilities, expiring in October 2007 and December 2009, are due on terms that range from 7 days to 12 months and are renewable. Borrowings under the Caja's fixed-rate facility are due and payable in January 2011; borrowings under a variable-rate facility are due and payable in March 2015. Borrowings under the Shinkin facility are due and payable in December 2009, with interest payable semiannually.

The Corporation's weighted-average cost of borrowings for the year ended December 31, 2005 was 4.07% compared with 3.42% for the year ended December 31, 2004.

After the financial difficulties that the Corporation faced in 2001-02, the IIC has been able to build up its liquidity position since then as a result of a much improved financial performance. At year-end 2005, cash plus marketable securities amounted to \$207.8 million compared with \$109.8 million for 2004. The ratio of liquid assets to total assets stood at 30.7% in 2005 compared with 22.5% in 2004. The ratio of liquid assets to total borrowings and long-term debt declined to 106.2% in 2005 from 137.2% in 2004 as a result of the issuance of a local-currency bond placed in the Colombian capital markets. Management has indicated that the Corporation intends to reduce its liquidity position during the year through increased lending, including \$100 million in approved loans that could be disbursed in the first semester of 2006.

IIC Bond Issue in Colombian Market

In December 2005, the IIC successfully placed a local currency bond in the Colombian capital markets for 150 billion Colombian pesos (approximately \$66 Million) maturing in 2010. Demand for the bonds exceeded the amount offered by 4.7 times.

The proceeds from the offering were used entirely to provide financing for small and medium-size companies in Colombia. The proceeds were lent to five Colombian leasing companies that expect to provide financing to more than 1,000 small and medium-sized companies.

Through the bond offering, the Corporation became the first multilateral organization to borrow and lend domestically in the same international market. Given the success of the offering, management expects that the Corporation will contemplate future local currency bonds issues in other in Latin American countries.

Earnings Trends And Profitability

In 2005, the Corporation posted a positive net income for a third year in a row after losses were reported during the 2001-2002 period. Net income came to \$13.7 million during 2005 compared with \$3.5 million for 2004 and \$2.2 million in 2003 – a loss of \$41.1 million was reported during 2002. The key elements behind the increased profitability reported during 2005 were the increased level of productive assets, higher interest rate levels, and a very low level of provisions resulting from recoveries and better macroeconomic conditions in the region. Unlike previous years when provisioning charges resulted in expenses of more than \$3 million in 2004 and nearly \$45 million in 2002 during last year the release of \$42 thousand in provisioning charges.

Income before provisions came to \$12 million in 2005, compared with \$6.8 million in 2004 and \$1.7 million in 2003. Return on assets improved to 2.03% in 2005 from 0.77% in 2004 and 0.54% in 2003; return on equity also improved, rising to 3.2% from 1.0% in 2004 and 0.76% in 2003. It is Moody's opinion that improved earnings and profitability reflect recent operational changes as well as the strategic initiatives introduced by management -- elements that have strengthened the IIC's underlying financial position.

2. From that sub-total 9% are classified as substandard, 6% as doubtful and 1% are considered at loss.

Strategic Initiatives

The IIC has implemented various organizational changes aimed at improving the overall financial performance of the Corporation and at assuring financial stability over time. After the financial struggles of the 2001- 2002 period, the shareholders developed an action plan intended to stop the losses to the Corporation's capital base by addressing weaknesses in certain key areas. The proposed organizational changes were incorporated into a two-year business plan which focused on restructuring credit operations, emphasizing the need for internal checks and balances. As a result of changes implemented, the Corporation has been able to increase productivity significantly as indicated by the increase that has been registered in the ratio of loan income to administrative expenses, which rose to 1.29 in 2005 from 1.12 in 2004 and a staggering 0.87 in 2003. Similarly, the ratio of administrative expenses to net loan and equity investments declined to 4.12% in 2005 from 4.54% in 2004 and 4.65% in 2003

In terms of the restructuring the credit assessment process, one of the most significant developments involved the creation of a credit risk committee whose purpose was to evaluate the risk associated to the Corporation's asset portfolio on a systematic basis by a ranking both loan and equity investments.³ The committee's efforts have allowed the Corporation to better recognize the credit risks derived from its asset base and to explicitly account for them by provisioning based on the credit rankings assigned. Additionally, the Corporation introduced a practice of partial write-offs of equity investments that are considered to qualify as permanently impaired. As a result, the equity portfolio has been reclassified into better asset categories, that are more coherent with the fair value of the investments.

Lending through financial institutions in the region has reported a significant increase in recent years, a development that has allowed the Corporation to respond more effectively to demands from borrowers in its member countries by expanding its coverage and providing lending to smaller enterprises. In order to accelerate this process, while assuring that credit standards were preserved, the Board approved in March 2005 a streamlined approval process for new loans that are channeled through top-tier financial institutions. As a result, the Corporation has implemented the equivalent of a fast-track process for loans to financial institutions that have already been identified as exceptionally creditworthy, a condition that virtually makes them pre-approved for credit amounts that are in accordance with the authorized limits. After a detailed analysis on the specific transaction is completed and has received the approval of the credit risk committee, loan proposals are sent to the Board for a final approval that takes place within five days. According to management, the fast-track approval process will serve as foundation for an increased loan volume in the coming years.

Related Research

Special Comments:

[Moody's Sovereign Ratings: A Ratings Guide, March 1999 \(43788\)](#)

[A Quantitative Model for Local Currency Government Bond Ratings, September 2003 \(79404\)](#)

[A Quantitative Model for Foreign Currency Government Bond Ratings, February 2004 \(81176\)](#)

Rating Methodologies:

[Revised Country Ceiling Policy, June 2001 \(67679\)](#)

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.

Rating History		
Date	Rating Action	Long Term Issuer Rating
15-Nov-03	Stable Outlook	STA
1-Oct-01	Assigned	Aa2

3. The credit committee ranks assets based on a 10 point scale. Loans/investments rated 8, 9 and 10 are considered to have questionable credit quality and are classified as substandard, doubtful and loss, respectively.

Inter-American Investment Corporation

	1999	2000	2001	2002	2003	2004	2005
BALANCE SHEET SUMMARY							
Cash	3,622	1,782	3,576	1,359	19,110	63,512	49,407
Marketable Securities	32,598	62,312	50,436	76,207	65,841	46,257	158,362
Loan Investments	267,973	269,644	275,417	268,827	306,314	342,010	432,307
Loan Allowance	(24,567)	(24,409)	(30,421)	(45,702)	(45,264)	(45,466)	(47,743)
Equity Investments	84,972	93,709	101,072	114,090	112,364	100,898	78,377
Equity Allowance	(10,186)	(15,961)	(27,032)	(41,146)	(41,177)	(30,681)	(9,415)
Mortgage Backed Securities	-	-	4,338	4,816	-	-	-
Total Investments	318,192	322,983	323,374	300,885	332,237	366,761	453,526
Fixed Assets	241	413	355	364	480	-	-
Other Assets	6,496	6,692	3,707	6,424	8,521	10,854	14,703
Total Assets	361,149	394,182	381,448	385,239	426,189	487,384	675,998
Accounts Payable	2,255	3,381	6,319	17,868	6,651	8,867	10,197
Accrued Interest	820	1,517	24	482	2	5	835
Borrowings	150,000	160,000	105,000	85,000	80,000	80,000	195,668
Total Liabilities	153,075	164,898	111,343	103,350	86,653	88,872	206,700
Capital	203,255	223,875	280,025	332,925	388,395	443,850	500,901
Retained Earnings	4,819	5,409	(9,920)	(51,036)	(48,860)	(45,338)	(31,603)
Unrealized Loss	-	-	-	-	-	-	-
Total Equity	208,074	229,284	270,105	281,889	339,535	398,512	469,298
Liabilities and Equity	361,149	394,182	381,448	385,239	426,188	487,384	675,998
INCOME STATEMENT SUMMARY							
	1999	2000	2001	2002	2003	2004	2005
Marketable Securities	2,175	3,306	2,873	1,706	1,284	1,079	5,315
Loan Investments	20,527	26,134	21,370	14,087	13,429	18,598	24,126
Equity Investments	1,494	1,544	3,422	2,176	2,556	4,219	2,237
Mortgage-backed Security	-	-	722	(1,215)	1,654	35	-
Advisory Services, etc.	3,516	3,222	3,138	2,110	3,032	2,506	4,319
Total Income	27,712	34,206	31,525	18,864	21,955	26,437	35,997
Admin Expenses	12,918	13,239	14,103	16,012	15,461	16,667	18,672
Provision for Losses	21,793	9,848	25,511	44,480	(515)	3,312	(42)
Unrealized Gain (Loss) on Derivative	-	-	619	(2,524)	1,906	-	35
Borrowing	5,945	10,529	6,621	2,012	2,926	2,937	5,185
Total Expenses	40,656	33,616	46,854	59,980	19,778	22,916	23,916
Effect of Nontrading (Borrowings-Related) Derivative Instruments	-	-	-	-	-	-	1,654
Net Income (Loss)	(12,944)	590	(15,329)	(41,116)	2,177	3,521	13,735

Inter-American Investment Corporation

	1999	2000	2001	2002	2003	2004	2005
FINANCIAL RATIOS							
Performance Statistics (%)							
Return on Total Assets	(3.6)	0.1	(4.0)	(10.7)	0.5	0.7	2.0
Return on Earning Assets	(3.7)	0.2	(4.1)	(10.9)	0.5	0.7	2.1
Return on Average Equity	(6.0)	0.3	(6.1)	(14.9)	0.7	1.0	3.2
Interest Coverage Ratio	(1.2)	1.1	(1.3)	(19.4)	1.7	2.2	3.6
Asset Quality							
Total Loans on Non-Accrual	32,226	40,516	83,246	62,434	51,820	64,278	51,085
Non-Accruals as % Gross Loans Out.	12.0	15.0	30.2	23.2	16.9	18.8	11.8
Non-Accruals as % Loan Loss Res.	131.2	166.0	273.6	136.6	114.5	141.4	107.0
Gross Write-offs (Loan & Equity) as % Gross Loans and Equity Investments	7.1	1.7	2.3	4.1	1.7	4.6	4.2
Net Write-offs (Loan & Equity) as % Gross Loans & Equity Investments	7.0	1.2	2.2	3.9	(0.0)	3.1	3.7
Loss Reserve to Net Write-offs (Loan & Equity) (X) [2]	1.4	9.5	6.8	5.8	(800.4)	5.6	3.0
Liquidity Ratios (%)							
Liquid Assets/Total Assets	10.0	16.3	14.2	20.1	19.9	22.5	30.7
Liquid Assets/Total Borrowings	24.1	40.1	51.4	91.3	106.2	137.2	106.2
Equity Ratios							
PIC + Accum. Earn. + Loss Res. as % Gross Assets [1]	61.3	62.1	74.6	78.1	83.1	84.2	71.8
PIC + Accum. Earn. + Loss Res. as % Gross Loans + Equity Investments [1]	68.8	74.2	87.0	96.3	101.7	107.2	103.1
Borrowings Outstanding as % Subscr. Cap. + Accum. Earn.	71.9	24.0	15.6	13.3	12.4	12.3	29.2
Equity Investments net of Loss Reserves as % PIC + Accum. Earnings [1]	35.9	33.9	27.4	25.9	21.0	17.6	14.7

[1] PIC equals Paid-in Capital

Ten Largest Exposures by Country of Domicile

(US\$ Thousands as of December 31, 2005)

	Loan	Equity	Total	%
Colombia	91,068	857	91,925	18.0
Brazil	82,280	2,764	85,044	16.7
Chile	29,100	14,967	44,067	8.6
Mexico	19,030	10,177	29,207	5.7
Ecuador	25,381	-	25,381	5.0
Argentina	20,032	612	20,644	4.0
Peru	20,481	-	20,481	4.0
Uruguay	20,140	250	20,390	4.0
Costa Rica	17,720	-	17,720	3.5
Nicaragua	17,327	-	17,327	3.4
Ten Largest Exposures [1]	342,559	29,627	372,186	72.9
Total	432,307	78,377	510,684	100.0

[1] The Corporation also has a \$79 million (15.5% of total) exposure designated as Regional, which consists of multi-country private equity investment funds.

IIC Ownership Distribution by ten largest shareholders

(As of December 2005)

	Capital Shares	Voting %
United States	17,600	25.1
Argentina	7,767	11.1
Brazil	7,767	11.1
Mexico	5,000	7.1
Venezuela	4,311	6.2
Spain	2,393	3.4
Japan	2,393	3.4
France	2,162	3.1
Italy	2,162	3.1
Chile	2,003	2.9
Ten Largest Shareholders	53,558	76.4
Total	70,069	100.0

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