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## Inter-American Investment Corporation

### Rating Rationale and Outlook

The Inter-American Investment Corporation (IIC) was established in 1986 as part of the Inter-American Development Bank Group (IDB), which also includes the Inter-American Development Bank (IDB) and the Multilateral Investment Fund (MIF). The Corporation's mission is to promote the economic development of its Latin American and Caribbean member countries by financing primarily small-and medium-size private enterprises.

The Corporation, which began operations in 1989, accomplishes its mission by making loan and equity investments where sufficient private capital is not otherwise available on reasonable terms. The IIC mobilizes project funding through co-financing, loan syndications, underwritings, and guarantees. Additionally, the Corporation provides financial and technical advisory services to clients.

IIC loans are made without the benefit of a sovereign guarantee. The Corporation receives its share capital from member countries and conducts its operational activities in its 26 regional member countries.

The IIC's Aa2 rating incorporates, in addition to its intrinsic credit profile, the implicit financial support that the Corporation derives from the IDB. The IIC's high level of capitalization is an integral element supporting its current rating.

Organizational changes have allowed the Corporation to overcome the financial difficulties faced during 2001-2002, reflecting of the commitment by management and the shareholders to make the adjustments required to restore financial conditions that support a stable outlook. Management has placed special emphasis on the need to overhaul credit policies, improve the quality of the loan and investment portfolios and strengthen the balance sheet.

Given the IIC's developmental role, the overall quality of its portfolio incorporates a high-risk component derived from the credit profile of its asset base. Consequently, the Corporation could experience sudden increases in overall credit risk during periods of financial stress in the region. However, in Moody's opinion, the IIC has developed an increased ability to address such situations in recent years.

The IIC's improved overall performance in recent years reflects the cumulative impact of strategic initiatives that have better balanced the Corporation's development mandate with the objective of financial self-sustainability. Improved credit management has strengthened the general profile of the IIC's asset base, a condition that should allow



the Corporation to minimize the potentially adverse consequences of future economic/financial downturns in the region.

## Strategic Initiatives

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The IIC has implemented various organizational changes aimed at improving its financial performance and at assuring financial stability over time. After the financial struggles of the 2001- 2002 period, the shareholders developed an action plan intended to stem losses in the Corporation's capital base by addressing key weaknesses. 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 ratio of loan income to administrative expenses which rose to 2.2X in 2006 from 1.3X in 2005 coming from a staggering 0.87 in 2003. Similarly, the ratio of administrative expenses to net loan and equity investments declined to 2.9% from 4.1% in 2005 and 4.7% in 2003.

Regarding the credit assessment process, a significant developments involved the creation of a credit risk committee whose purpose is to evaluate the risk associated with the Corporation's asset portfolio by ranking both loan and equity investments.<sup>1</sup> 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 making provisions based on the credit rankings assigned. The Corporation also introduced the practice of recognizing changes in the value of equity investments. As a result, equity portfolio investments have been reclassified into asset categories that better reflect their fair value.

As part of the strategic initiatives, the Corporation also decided to accelerate lending through financial institutions, an activity that has increased significantly in recent years. This development has allowed the IIC to respond more promptly to demands from borrowers in its member countries to expand its coverage in the region. In order to accelerate this type of lending while assuring that credit standards are preserved, the Board approved in 2005 a streamlined approval process for new loans channeled through top-tier financial institutions. This has led to a fast-track process for loan authorizations to financial institutions already identified as exceptionally creditworthy, which makes them virtually pre-approved in credit amounts that fall under the authorized limits. To a large extent, the fast-track approval process has served as the main foundation of increased loan volume in recent years.

## Capital Adequacy

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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 2006, \$368 million had been paid with the 8th installment due by October 2007.

To date, while most of the forty three member countries have made their respective payments, arrears on capital contributions still exist. Management has indicated that, with no further capital increases contemplated at this time, prior to the October due date the Board of Directors will determine how to address the issue of capital arrears.

The Corporation's capital was \$568 million in 2006, compared with \$500.9 million in 2005. The United States is the largest shareholder, contributing 25% of the total subscribed capital, while Argentina and Brazil each own 11% -- the 10 largest shareholders account for over 75% of subscribed capital. Korea joined as a new shareholder in 2005 and fully paid in its capital contribution

High capitalization is an important support element of the IIC's rating as it enhances its financial capabilities to withstand shocks, such as what occurred several years ago. As of year end 2006, paid-in capital plus accumulated earnings and loss reserves amounted to 90% of total gross loans and equity investments. This figure compares with the ratio of 103% in 2005 and the 69% ratio prior to the 1999 capital increase agreement.

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<sup>1</sup> The credit committee ranks assets based on a 10-point scale. Loans and investments with rankings of 8, 9 and 10 are considered to have questionable credit quality and are classified as substandard, doubtful, and loss, respectively.

## Asset Composition and Quality

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The Corporation makes loan and equity investments to private-sector companies and financial institutions domiciled in the 26 Latin American and Caribbean member countries. As of December 31, 2006, the countries with the largest aggregate credit exposure to the Corporation were Colombia (17.7 %), Brazil (16.1%), and Chile (11.4%). During the year, the most important changes in the Corporation's credit exposures were related to Mexico and Peru, as their respective shares increased to 9.7% and 10.4 % from 4.4% and 4.7% in 2005, respectively.

Last year, the Corporation approved \$333.7 million which was allocated to 46 new projects in 13 countries in addition to two regional projects. These numbers compare with \$341.7 million in 37 project operations in 15 member countries and three projects with regional coverage during 2005.

In Moody's opinion, the significant increase reported in the approvals volume during 2005 and 2006 is a reflection 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. Additionally, it is important to note that loans to financial institutions were the main factor behind the increase in the Corporation's loan portfolio. Such loan portfolio accounted for about 70% of the total with outstanding loans to those institutions going to \$443 million in 2006 from \$245 million the previous year.

Total investments, including loans and equities, net of allowances for losses, amounted to \$647 million, up from \$454 million in 2005 and \$367 million in 2004. Management has indicated that the Corporation intends to reduce in coming years its exposure to equity investments, which involve limited partnerships and direct investments. Still, the Corporation will continue to maintain equity investments, although their relative share will be modest when compared with previous years. Equity investments represented, at one point, 35% of total assets compared with the current share of less than 10%.

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. During 2006, provisions for loan losses resulted in a release of \$1.6 million dollars, a shift with respect to last year when an expense charge of \$3.5 million was reported.

As a result of changes in accounting principles, the Corporation recognized a \$9.4 million provision of its equity investment from its prior balance sheet directly in the investments; additionally \$8.8 million were written off from its loan portfolio. These adjustments reflect an ongoing process carried out by management and supported by provisions made in previous years that has allowed the Corporation 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 past-due loans which represented only 1.5% of total loans in 2006 compared with 5.5% in 2005, 9.5% in 2004 and a peak of 16.7% in 2002. Loans on non-accrual have declined as well, falling to 4.6% of total loans outstanding in 2006 from 11.8% in 2005 and 29.8% in 2001. This reduction was driven by a combination of factors that included (i) write-offs, (ii) improved asset quality, and (iii) a nearly \$200 million increase in loans outstanding. It is important to note that while this ratio is higher than that reported by other multilateral institutions, the IIC has continued to receive payments on most loans reported as non-accrual -- the Corporation maintains the practice of keeping loans on a non-accrual status for a one-year probationary period even after they begin performing.

During 2006, the IIC maintained loan-loss reserves equal to 427% of past-due loans and 139% of total non-accruals. During 2005, the equivalent ratios stood at 200% and 94%, respectively. According to the guidelines established by the IIC's risk committee, 92% of outstanding loans and equity investments are classified as satisfactory compared with 84% in 2005, while 8% were considered to be problematic compared with 16% in 2005.

## **Borrowings, Long-Term Debt and Liquidity**

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The Corporation's outstanding borrowings consist of term and revolving-credit facilities with the IDB, and other European and Japanese financial institutions. Borrowings under the \$300 million IDB facility, which the Corporation has never tapped, are due 15 years after disbursement and are renewable -- the Corporation renewed in 2005 the IDB facility until November 2010.

In 2006, the IIC entered into five new credit agreements with Rabobank, Caja Madrid, Natexis, Caixa Geral de Portugal and BBVA-Bancomer, increasing its outstanding borrowings by \$145.2 million and bringing the total outstanding to \$275.2 million -- the IIC can draw an additional \$200 million from existing credit facilities, not including the IDB's credit facility.

In December 2005, the Corporation issued a local currency-denominated bond of some \$66 million in the Colombian market. Through this bond offering, the IIC became the first multilateral organization to borrow locally in order to fund domestic lending, a practice that the Corporation expects to maintain, contingent upon the Corporation's ability to obtain favorable pricing and to enter swap transactions at reasonable terms.

The Corporation's weighted-average cost of borrowings plus long term debt for the year ended December 31, 2006 was 5.38% compared with 4.07% for the year ended December 31, 2005.

The IIC has been able to build up a solid liquidity position which has been reinforced by a much improved financial performance in recent years. At year-end 2006, cash plus marketable securities amounted to \$260.2 million compared with \$207.8 million for 2005. The ratio of liquid assets (cash + marketable securities) to total assets stood at 27.7% in 2006 compared with 30.7% in 2005; the ratio of liquid assets to total borrowings and long-term debt declined to 76% in 2006 from 106.2% in 2005, largely as a result of more active borrowings on the part of the Corporation.

## **Earning Trends and Profitability**

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In 2006, the Corporation posted a positive net income for a fourth consecutive year after losses were reported during the 2001-2002 period. Moreover, net income reported a substantial increase, going to \$ 39.4 million in 2006 from \$13.7 million in 2005 and \$3.5 million for 2004. The pattern observed in pre-provision income was similar, as it came to \$37.9 million in 2006, from \$12 million in 2005 and \$6.8 million in 2004.

While the increased profitability observed during 2006 reflected, in part, the presence of an increased level of productive assets, higher interest rates, and a low level of provisions, it is also important to note that unique elements were present behind last year's better-than-anticipated financial performance. Particularly important in this respect were high returns on equity investments derived from realized gains on various disinvestments, equity investment-related income amounted to \$15.8 million in 2006.

In this respect, even though similar returns should not be expected in the future, prospects remain favorable as fundamental considerations (i.e., improved asset quality of the loan portfolio) should support higher-quality earnings and continued profitability in the coming years. The latter is consistent with management's intention to define, for the first time, profitability targets that assure the financial sustainability of the IIC over the medium-term.

The return-on-assets indicator improved significantly reaching to 4.2% in 2006 compared to 2.0% in 2005 and 0.77% in 2004. The return-on-equity indicator reported similar improvement going to 7.5% in 2006 from 3.2% in 2005 and 1.0% in 2004. Overall, improved earnings and profitability indicators reflect the impact on the Corporation's financial performance of operational changes and strategic initiatives introduced in previous years, elements that have strengthened the IIC's underlying financial position.

## Rating History

Inter-American Investment Corporation		
	LT Issuer Rating	Date
Outlook Assigned	STA	November-03
Rating Assigned	Aa2	October-01

## Related Research

### Special Comments:

[A Guide to Moody's Sovereign Ratings, July 2006 \(98177\)](#)

[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 Methodology:

[Piercing the Country Ceiling: An Update, January 2005 \(91215\)](#)

[Revised Foreign-Currency Ceilings to Better Reflect Reduced Risk of a Payments Moratorium in Wake of Government Default, May 2006 \(97555\)](#)

*To access any of these reports, click on the entry above. Note that these references are current as of the date o*

## Financial Statistics

Inter-American Investment Corporation								
BALANCE SHEET SUMMARY								
	1999	2000	2001	2002	2003	2004	2005	2006
<b>Cash</b>	<b>3,622</b>	<b>1,782</b>	<b>3,576</b>	<b>1,359</b>	<b>19,110</b>	<b>63,512</b>	<b>49,407</b>	<b>69,451</b>
<b>Marketable Securities</b>	<b>32,598</b>	<b>62,312</b>	<b>50,436</b>	<b>76,207</b>	<b>65,841</b>	<b>46,257</b>	<b>158,362</b>	<b>190,756</b>
Loan Investments	267,973	269,644	275,417	268,827	306,314	342,010	432,307	619,390
Loan Allowance	(24,567)	(24,409)	(30,421)	(45,702)	(45,264)	(45,466)	(47,743)	(39,933)
Equity Investments	84,972	93,709	101,072	114,090	112,364	100,898	78,377	67,423
Equity Allowance	(10,186)	(15,961)	(27,032)	(41,146)	(41,177)	(30,681)	(9,415)	-
Mortgage Backed Securities	-	-	4,338	4,816	-	-	-	-
<b>Total Investments</b>	<b>318,192</b>	<b>322,983</b>	<b>323,374</b>	<b>300,885</b>	<b>332,237</b>	<b>366,761</b>	<b>453,526</b>	<b>646,880</b>
<b>Fixed Assets</b>	<b>241</b>	<b>413</b>	<b>355</b>	<b>364</b>	<b>480</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Other Assets</b>	<b>6,496</b>	<b>6,692</b>	<b>3,707</b>	<b>6,424</b>	<b>8,521</b>	<b>10,854</b>	<b>14,703</b>	<b>32,774</b>
<b>Total Assets</b>	<b>361,149</b>	<b>394,182</b>	<b>381,448</b>	<b>385,239</b>	<b>426,189</b>	<b>487,384</b>	<b>675,998</b>	<b>939,861</b>
Accounts Payable	2,255	3,381	6,319	17,868	6,651	8,867	10,197	9,222
Accrued Interest	820	1,517	24	482	2	5	835	1,504
Borrowings	150,000	160,000	105,000	85,000	80,000	80,000	195,668	342,229
<b>Total Liabilities</b>	<b>153,075</b>	<b>164,898</b>	<b>111,343</b>	<b>103,350</b>	<b>86,653</b>	<b>88,872</b>	<b>206,700</b>	<b>352,955</b>
Capital	203,255	223,875	280,025	332,925	388,395	443,850	500,901	568,060
Retained Earnings	4,819	5,409	(9,920)	(51,036)	(48,860)	(45,338)	(31,603)	7,806
Accumulated Other Comprehensive Income								11,040
Unrealized Loss								
<b>Total Equity</b>	<b>208,074</b>	<b>229,284</b>	<b>270,105</b>	<b>281,889</b>	<b>339,535</b>	<b>398,512</b>	<b>469,298</b>	<b>586,906</b>
<b>Liabilities and Equity</b>	<b>361,149</b>	<b>394,182</b>	<b>381,448</b>	<b>385,239</b>	<b>426,188</b>	<b>487,384</b>	<b>675,998</b>	<b>939,861</b>

<b>INCOME STATEMENT SUMMARY</b>								
	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Income</b>								
Loan Investments	20,527	26,134	21,370	14,087	13,429	18,598	24,126	41,705
Marketable Securities	2,175	3,306	2,873	1,706	1,284	1,079	5,315	9,963
Equity Investments	1,494	1,544	3,422	2,176	2,556	4,219	2,237	15,821
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	4,401
<b>Total Income</b>	<b>27,712</b>	<b>34,206</b>	<b>31,525</b>	<b>18,864</b>	<b>21,955</b>	<b>26,437</b>	<b>35,997</b>	<b>71,890</b>
<b>Expenses</b>								
Admin Expenses	12,918	13,239	14,103	16,012	15,461	16,667	18,672	19,081
Provision for Losses	21,793	9,848	25,511	44,480	(515)	3,312	(42)	(1,571)
Other Unrealized Gain (Loss)	-	-	619	(2,524)	1,906	-	35	(92)
Borrowing	5,945	10,529	6,621	2,012	2,926	2,937	5,185	14,234
<b>Total Expenses</b>	<b>40,656</b>	<b>33,616</b>	<b>46,854</b>	<b>59,980</b>	<b>19,778</b>	<b>22,916</b>	<b>23,916</b>	<b>32,382</b>
	-	-	-	-	-	-	-	-
<b>Effect of Nontrading (Borrowings-Related)</b>							<b>1,654</b>	<b>(99)</b>
<b>Derivative Instruments</b>								
<b>Net Income (Loss)</b>	<b>(12,944)</b>	<b>590</b>	<b>(15,329)</b>	<b>(41,116)</b>	<b>2,177</b>	<b>3,521</b>	<b>13,735</b>	<b>39,409</b>

<b>FINANCIAL RATIOS</b>								
	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Performance Statistics (%)</b>								
Return on Total Assets	(3.6)	0.1	(4.0)	(10.7)	0.5	0.7	2.0	4.2
Return on Earning Assets	(3.7)	0.2	(4.1)	(10.9)	0.5	0.7	2.1	4.3
Return on Average Equity	(6.0)	0.3	(6.1)	(14.9)	0.7	1.0	3.2	7.5
Interest Coverage Ratio	(1.2)	1.1	(1.3)	(19.4)	1.7	2.2	3.6	3.8
<b>Asset Quality</b>								
Total Loans on Non-Accrual	32,226	40,516	83,246	62,434	51,820	64,278	51,085	28,704
Non-Accruals as % Gross Loans Out.	12.0	15.0	30.2	23.2	16.9	18.8	11.8	4.6
Non-Accruals as % Loan Loss Res.	131.2	166.0	273.6	136.6	114.5	141.4	107.0	71.9
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	2.7
Net Write-offs (Loan & Equity) as % Gross Loans & Equity Investments	7.0	1.2	2.2	3.9	(0.0)	3.1	3.7	2.3
Loss Reserve to Net Write-offs (Loan & Equity) (X) [2]	1.4	9.5	6.8	5.8	(800.4)	5.6	3.0	2.6
<b>Liquidity Ratios (%)</b>								
Liquid Assets/Total Assets	10.0	16.3	14.2	20.1	19.9	22.5	30.7	27.7
Liquid Assets/Total Borrowings	24.1	40.1	51.4	91.3	106.2	137.2	106.2	76.0
<b>Equity Ratios</b>								
PIC + Accum. Earn. + Loss Res. as % Gross Assets [1]	61.3	62.1	74.6	78.1	83.1	84.2	71.8	62.8
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	89.7
Borrowings Outstanding as % Subscr. Cap. + Accum. Earn.	71.9	24.0	15.6	13.3	12.4	12.3	29.2	48.1
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	11.7
[1] PIC equals Paid-in Capital								

**Ten Largest Exposures in the Outstanding  
Portfolio by Country of Domicile**

(US\$ Thousands as of December 31, 2006)

	Loan	Equity	Total	%
Colombia	120,847	429	121,276	17.7
Brazil	110,240	-	110,240	16.1
Chile	63,052	14,968	78,020	11.4
Mexico	59,836	8,789	68,625	10.0
Peru	68,341	-	68,341	10.0
Ecuador	37,025	-	37,025	5.4
El Salvador	24,000	-	24,000	3.5
Costa Rica	16,099	-	16,099	2.3
Uruguay	14,755	265	15,020	2.2
Nicaragua	14,269	-	14,269	2.1
<b>Ten Largest Exposures [1]</b>	<b>528,464</b>	<b>24,451</b>	<b>552,915</b>	<b>80.5</b>
<b>Total</b>	<b>619,390</b>	<b>67,423</b>	<b>686,813</b>	<b>100.0</b>

[1] The Corporation also has a \$78 million (11.4% 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 2006)

	Capital Shares	Voting %
United States	17,600	25.0
Argentina	7,767	11.0
Brazil	7,767	11.0
Mexico	5,000	7.1
Venezuela	4,311	6.1
Spain	2,393	3.4
Japan	2,393	3.4
France	2,162	3.1
Italy	2,162	3.1
Chile	2,003	2.8
<b>Ten Largest Shareholders</b>	<b>53,558</b>	<b>76.1</b>
<b>Total</b>	<b>70,370</b>	<b>100.0</b>

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