

# Credit Analysis



April 2008

## Inter-American Investment Corporation

### Summary Rating Rationale

The Aa2 rating assigned to the Inter-American Investment Corporation (IIC) reflects a credit and financial profile characterized by: (i) strong shareholder support; (ii) preferred creditor status; (iii) implicit financial support derived from membership in the Inter-American Development Bank (IDB) Group (iv) adequate financial management; and (v) robust capitalization.

The Corporation, which began operations in 1989, is mandated by its charter to promote the economic development of its Latin American member countries by encouraging the establishment, expansion, and modernization of private enterprises, preferably those that are small and medium-scale. All of the IIC's direct clients are private enterprises —preferably, although not exclusively, small and medium size.

The rating is constrained by the concentration of the Corporation's lending portfolio in speculative-grade countries typically characterized by high economic volatility. Balance sheet risks resulting from the Corporation's non-government guaranteed lending to small- and medium-size private sector companies also represent a limiting factor for the rating.

The IIC's rating incorporates the view that the Corporation will continue to effectively manage credit risks derived from the challenging operational environment present in the countries where lending activities are carried out. Strong support from its highly-rated non-Latin American shareholders, and the implicit financial support the Corporation derives from its membership in Inter-American Development Bank Group, constitute integral elements of the IIC's current rating.

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Inter-American Investment Corporation and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. [Click here to link.](#)



**Moody's Investors Service**

## Inter-American Investment Corporation

### Organizational Structure and Strategy

The IIC was established in 1986 as part of the IDB Group. While the IIC is affiliated with the IDB Group, the Corporation is legally autonomous, and its resources and management are separate from those of the Inter-American Development Bank.

The Corporation receives its share capital from forty-three member countries with voting power proportional to each country's paid-in shares. All the powers of the Corporation are vested in its Board of Governors, which appoints a Board of Executive Directors in which authority and powers are delegated to conduct operations.

The IIC is mandated by its charter to promote the economic development of its regional member countries by encouraging the establishment, expansion, and modernization of small-and medium-size private enterprises. To fulfill its mandate, the IIC conducts operations with 26 Latin American and Caribbean member countries offering a range of financial products and services including long-term loans, guarantees, and equity investments, in addition to offering lines of credit through local financial intermediaries that provide funding for corporate investments, refinancing, and working capital. All IIC loans are made without the benefit of a sovereign guarantee. The IIC also provides structured loans, financing for private equity funds, and loans for supply chain support programs.

Given the IIC's developmental mandate and the nature of its portfolio, the Corporation is exposed to substantial increases in credit risk during periods of regional financial distress, since conditions arising during those episodes can lead to a sudden deterioration in the credit profile of its borrowers. Still, the IIC has significantly increased its ability to address such situations in recent years.

### Organizational Changes and Major Overhaul of Credit Processes

An improved overall performance in recent years reflects the cumulative impact of strategic initiatives and organizational changes undertaken to overcome financial difficulties faced as a result of adverse regional shocks. Actions taken reflect a strong commitment on the part of management and shareholders to implement the adjustments required to restore medium-term financial sustainability and to balance the Corporation's development mandate with the objective of assuring medium-term financial self-sustainability.

Organizational changes aimed at improving the IIC's financial performance were incorporated into an action plan whose main objective was to stem losses to the Corporation's capital base experienced during the 2001-2002 period. The plan involved a major overhaul of credit policies, including a major restructuring of the Bank's credit assessment process, which has contributed to improve the overall quality of the IIC's loan and investment portfolios, while strengthening the Corporation's balance sheet.

A key initiative was the creation of a credit risk committee whose purpose was to evaluate the risk profile of the Corporation's investment portfolio. For that purpose, the committee designed a credit ranking scale for loan and equity investments which has allowed the Corporation to better recognize credit risks, and to explicitly account for credit risks by making provisions based on the rankings. Also, the reclassification of the portfolio of equity investments into asset categories more consistent with fair-value estimates has led to adjustments in their value.

Another outcome of the strategic initiatives involved a decision to increase lending through top-tier financial institutions, a development that has allowed the Corporation to significantly expand its loan portfolio in recent years. To assure that credit standards were preserved as the loan portfolio expanded, the Corporation designed and implemented a process of pre-qualification of financial institutions intended to identify those deemed to be exceptionally creditworthy. Concurrently, a fast-track approval process was developed to streamline loan authorizations for amounts less than the authorized limits set for previously-qualified financial institutions. The emphasis on lending through financial institutions, combined with the fast-track approval process, has become the mainstay of increased loan volume in recent years.

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Overall, administrative changes implemented to date have allowed the Corporation to significantly increase productivity as evidenced by the improvement reported in various performance indicators. The ratio of administrative expenses to total (loan + equity) investments declined to 2.79% in 2007 from 2.95% in 2006 and 4.12% in 2005 (2003-2004 average = 4.6%). Alternatively, the ratio of loan income (interest + fee) to administrative expenses increased to 2.56X from 2.19X in 2006 and 1.29X in 2005 (2003-2004 average = 0.99X).

## Asset/Liability Management and Liquidity

### Robust Loan Growth Expected to Moderate

The Corporation makes loan and equity investments to private-sector companies and financial institutions domiciled in the 26 Latin American and Caribbean member countries. Total investments, which include loan and equity investments (net of allowances for losses) amounted to \$800 million during 2007, up from \$647 million in 2006.

As of December 31, 2007, the countries with the largest aggregate credit exposures to the IIC were Colombia (17.3%), Brazil (17.2%), and Peru (13.8%). During the year, the most important changes in the Corporation's credit exposures were related to Peru and Nicaragua, as their respective shares increased to 13.8% and 4.1% from 10.0% and 2.1% in 2006, respectively.

The Corporation approved loans for \$470.2 million last year, which were allocated to 62 new projects in 15 countries in addition to 2 regional projects. These numbers compare with \$337.7 million in 46 project operations in 13 member countries and two projects with regional coverage during 2006. The significant increase in loan approvals reported during the last three years is a direct result of streamlined origination, approval and disbursement processes.

There have not been significant changes in the sectoral composition of the loan portfolio, with the bulk still going to financial institutions, which account for 75% of total outstanding loans. In addition to their dominant share, loans to financial institutions have been the most dynamic component of the IIC's asset portfolio, increasing to \$600 million in 2007 from \$443 million in 2006 and \$245 million in 2005.

After an extended period of more than 30% nominal growth in the Corporation's loan portfolio, future loan growth will be constrained by the IIC's ability to generate positive net income (i.e., retained earnings) and by increases in its borrowings and long-term debt, given that currently there is no consideration being given to seeking a capital increase. Accordingly, Moody's anticipates that loan growth will proceed at a more moderate pace in the coming years.

### Diminished Role of Equity Investments

Equity investments, which involve limited partnerships and direct investments, have been declining during the last four years. After representing a significant share of IIC's total investments, equity-related investments totaled \$43 million in 2007 from \$71.1 million in 2003, with their relative share of total investments declining to 5.1% from 21% during the 2003-2007 period.<sup>1</sup>

Declining equity investments reflect (i) adjustments in portfolio valuations given fair-value assessments, (ii) divestures in equity positions held in regional equity funds, and (iii) the IIC's decision to sell direct equity positions. At a more fundamental level, the decline reflects a more conservative view towards equity investments and their role in the IIC's portfolio, as the Corporation has increasingly come to view its loan portfolio as the main instrument to carry out its development mandate.

Accordingly, IIC officials indicated that equity positions are expected to increase at a moderate pace in the coming years, accounting for 10% to 15% of the Corporation's investment portfolio.

<sup>1</sup> Equity investments amounted to \$70.2 million in 2004, \$68.9 million in 2005, and \$67.4 million in 2006.

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### Increased Financial Leverage; Solid Liquidity Position

The Corporation's outstanding borrowings consist of term and revolving-credit facilities held mostly with European and Japanese financial institutions. The IIC also has access to direct funding from the IDB through a \$300 million facility. Borrowings under the IDB facility are due fifteen years after disbursement and are renewable. The IDB facility, which has never been tapped by the IIC, was last renewed in 2005 allowing the Corporation to borrow up to \$300 million until November 2010.

The IIC has credit facilities with Rabobank (Netherlands), Caja Madrid (Spain), Natixis (France), Caixa Geral de Portugal, and BBVA-Bancomer (Mexico). During 2007, the Corporation also established new credit facilities with HSBC (Hong Kong), Banco Itau (Brazil), Banco de la Nación Argentina, and Banco Continental (Peru). IIC's total credit facilities (excluding the IDB facility) amounted to \$610 million, with borrowings outstanding totaling \$380.5 million at year-end 2007, compared with \$275.2 million in 2006 and \$130 million in 2005.

During 2007, the IIC borrowed \$103.5 million to fund the Corporation's ordinary operations. The latest IIC borrowing transaction involved a US\$50 million syndicated term loan arranged by Mizuho Corporate Bank in March 2008. This landmark transaction, the IIC's first syndication in the Japanese market, has contributed to further diversify the Corporation's funding base.<sup>2</sup>

Increased borrowings have contributed to a steady rise in the IIC's financial leverage indicators. The liabilities-to-equity ratio stood at 69% in 2007 compared with 60% in 2006 and 44% in 2005 (2003-2004 average = 24%). The weighted average cost of borrowings was 5.79% during 2007, compared with an average annual cost of 5.38% in 2006. The average cost of borrowings and long-term debt was 6.17% during 2007, compared with 5.53% for 2006.

The IIC has built up a solid liquidity position which has been reinforced in recent years as a result of the Corporation's much improved financial performance. At year-end 2007, liquid assets (cash + marketable securities) amounted to \$410.4 million compared with \$260.2 million in 2006. The ratio of liquid assets to total assets stood at 33% in 2007 compared with 27.7% in 2006, while the ratio of liquid assets to total borrowings and long-term debt increased to 82% in 2007 from 76% in 2006.

### Asset Quality

#### Steady Improvement in Credit Quality of Loan Portfolio

The credit quality of the Corporation's portfolio reflects the risk profile of the regional market segment it has a mandate to serve as dictated by its charter. Improved credit management has strengthened the general risk profile of the IIC's asset base, allowing the Corporation to reduce the potentially adverse consequences of regional economic/financial downturns on its financial results.

Much improved asset quality in the Corporation's loan portfolio is evidenced from the decline observed in past-due loans. These were virtually nil in 2007, compared to ratios of past-due loans to total outstanding loans of 1.5% in 2006, 5.5% in 2005, and 16.7% in the peak year of 2002. Non-accrual loans have declined as well, representing 1.8% of total outstanding loans in 2007 compared with 4.6% in 2006, 11.8% in 2005, and 29.8% in the peak year 2001.<sup>3</sup> During 2007, the IIC maintained loan-loss reserves equal to 283% of non-accrual loans compared to 139% in 2006 and 95% in 2005.

<sup>2</sup> In 2005, the IIC placed a local currency-denominated bond for some \$66 million in the Colombian market becoming the first multilateral organization to borrow locally to fund domestic lending. In November 2007, the IIC issued Mexican peso-denominated notes for some \$43.9 million whose proceeds were used to provide financing in local markets. The Corporation intends to carry similar operations in the future contingent upon (i) the presence of favorable pricing, and (ii) the availability of swap transactions at reasonable terms.

<sup>3</sup> IIC receives payments on some loans reported as non-accrual as the Corporation maintains the practice of keeping the non-accrual status for a one-year probationary period even after loans begin performing.

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Based on the IIC's credit risk rankings, no investments from its loan and equity investment portfolio were reported in the lowest (*loss*) category during 2007, while 0.1% the portfolio was classified as *doubtful* and 2.6% was *substandard*. In 2006, the corresponding breakdown was 0.8% (*loss*), 0.6% (*doubtful*) and 5.8% (*substandard*). Overall, in 2007, 97.3% of the IIC's loan and equity investment portfolio was classified as *satisfactory*, compared with 92% in 2006 and 84% in 2005.

Even though asset quality would be adversely affected in the event of an economic/financial crisis in the region, the Corporation is better prepared to manage such a situation. Improved credit quality and high loan-loss allowances have significantly strengthened the IIC's balance sheet. As a result, the IIC's financial standing is fundamentally different from that prevailing in 2000-2001, when a much weaker balance sheet made the IIC extremely vulnerable to regional shocks.

## Profitability

### Increased Profits Over a Five-year Period

In 2007, the IIC posted positive net income for the fifth consecutive year. Net income increased substantially from \$83.5 million last year from \$ 39.4 million in 2006.<sup>4</sup> The pattern observed in income before provisions was similar, rising to \$86.7 million in 2007 from \$37.8 million in 2006.<sup>5</sup>

While increased profitability was associated with a higher level of productive assets and lower loan-loss provisions, an important contributing factor to last year's outstanding financial performance involved high returns on equity investments as a result of realized gains on various disinvestments. Equity investment-related income amounted to \$56 million in 2007 compared to \$15.8 million in 2006, due to the sale of an equity position by the IIC that ultimately generated a \$40 million profit.

The Return-on-Assets indicator improved significantly, reaching 6.7% in 2007 compared with 4.2% in 2006. Return-on-Equity reported similar improvement, rising to 12.6% in 2007 from 7.5% in 2006.<sup>6</sup> While reinforced to an important degree by the internal operational changes introduced in previous years, IIC's earnings and profitability indicators also reflect extremely favorable regional economic conditions over an extended period of time.

Financial prospects remain favorable given indications of improved asset quality and the anticipation of additional increases in the IIC's loan portfolio. While these conditions should support continued profitability in the coming years, thereby contributing to medium-term financial sustainability, net income could decline in the near term as last year's figure incorporated one-time factors (i.e., high equity investment-related income) that are unlikely to be replicated during 2008.

## Capital Adequacy

### High Capitalization Ratios Support Current Ratings

Unlike most other multilateral development banks, the IIC does not have any callable capital; all of its capital is paid in. The Corporation was established with initial paid-in capital of \$200 million. In 1999, the member countries agreed to a \$500 million capital increase to be paid in eight yearly installments, the last of which was payable on October 2007. Management has indicated that no additional capital increases are contemplated at present.

Not all capital subscription installments were paid in accordance with the deadlines, and currently there are some capital arrears. Moody's notes that arrears are relatively small and believes that their existence is not indicative of any material erosion in shareholder support. IIC officials have indicated that the Corporation continues to work with member countries to resolve this issue and that it expects that all shares authorized under the 1999 capital increase will be eventually paid.

<sup>4</sup> Net income was \$13.7 million in 2005 and \$3.5 million in 2004. Income before provisions was \$17.3 million in 2005; pre-provision losses of \$2.4 million and \$2.7 million were reported in 2004 and 2003, respectively.

<sup>5</sup> Loan-loss provisions resulted in a \$3.2 million expense charge in 2007. Provisions for \$1.6 million were released in 2006 resulting in a credit charge.

<sup>6</sup> ROA was 2.0% in 2005 and 0.77% in 2004. Alternatively, ROE was 3.2% in 2005 and 1.0% in 2004.

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The Corporation's paid-in capital was \$636.5 million in 2007, compared with \$568 million in 2006. 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 76% 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 capability to withstand shocks. As of year-end 2007, equity amounted to 91.8% of total gross loans and equity investments, compared with 90.7% in 2006 and 103.5% in 2005. Even though the ratio has registered a moderate decline, partly driven by a significant increase in the IIC's asset portfolio (30% annual rate) during 2005-2007, its gearing is still indicative of a relatively strong capital position.

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## BALANCE SHEET SUMMARY

	1999	2000	2001	2002	2003	2004	2005	2006	2007
<i>Cash</i>	3,622	1,782	3,576	1,359	19,110	63,512	49,407	69,451	70,046
<i>Marketable Securities</i>	32,598	62,312	50,436	76,207	65,841	46,257	158,362	190,756	340,333
Loan Investments	267,973	269,644	275,417	268,827	306,314	342,010	432,307	619,390	796,910
Loan Allowance	(24,567)	(24,409)	(30,421)	(45,702)	(45,264)	(45,466)	(47,743)	(39,933)	(39,481)
Equity Investments	84,972	93,709	101,072	114,090	112,364	100,898	78,377	67,423	43,017
Equity Allowance	(10,186)	(15,961)	(27,032)	(41,146)	(41,177)	(30,681)	(9,415)	-	-
Mortgage Backed Securities	-	-	4,338	4,816	-	-	-	-	-
<i>Total Investments</i>	318,192	322,983	323,374	300,885	332,237	366,761	453,526	646,880	800,446
<i>Fixed Assets</i>	241	413	355	364	480	-	-	-	-
<i>Other Assets</i>	6,496	6,692	3,707	6,424	8,521	10,854	14,703	32,774	33,391
<i>Total Assets</i>	361,149	394,182	381,448	385,239	426,189	487,384	675,998	939,861	1,244,216
Accounts Payable	2,255	3,381	6,319	17,868	6,651	8,867	10,197	9,222	8,003
Accrued Interest	820	1,517	24	482	2	5	835	1,504	2,707
Borrowings	150,000	160,000	105,000	85,000	80,000	80,000	195,668	342,229	498,966
<i>Total Liabilities</i>	153,075	164,898	111,343	103,350	86,653	88,872	206,700	352,955	509,676
Capital	203,255	223,875	280,025	332,925	388,395	443,850	500,901	568,060	636,526
Retained Earnings	4,819	5,409	(9,920)	(51,036)	(48,860)	(45,338)	(31,603)	7,806	90,168
Accumulated Other Comprehensive Income								11,040	7,846
Unrealized Loss									
<i>Total Equity</i>	208,074	229,284	270,105	281,889	339,535	398,512	469,298	586,906	734,540
<i>Liabilities and Equity</i>	361,149	394,182	381,448	385,239	426,188	487,384	675,998	939,861	1,244,216

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## INCOME STATEMENT SUMMARY

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Marketable Securities	2,175	3,306	2,873	1,706	1,284	1,079	5,315	9,963	12,440
Loan Investments	20,527	26,134	21,370	14,087	13,429	18,598	24,126	41,705	57,187
Equity Investments	1,494	1,544	3,422	2,176	2,556	4,219	2,237	15,821	56,032
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	6,135
<i>Total Income</i>	27,712	34,206	31,525	18,864	21,955	26,437	35,997	71,890	131,794
Admin Expenses	12,918	13,239	14,103	16,012	15,461	16,667	18,672	19,081	22,307
Provision for Losses	21,793	9,848	25,511	44,480	(515)	3,312	(42)	(1,571)	3,189
Other Unrealized Gain (Loss)	-	-	619	(2,524)	1,906	-	35	(92)	(669)
Borrowing	5,945	10,529	6,621	2,012	2,926	2,937	5,185	14,333	23,494
<i>Total Expenses</i>	40,656	33,616	46,854	59,980	19,778	22,916	23,916	32,481	48,321
	-	-	-	-	-	-	-	-	-
<i>Effect of Non-trading (Borrowings-Related) Derivative Instruments</i>	-	-	-	-	-	-	1,654	-	-
<i>Net Income (Loss)</i>	(12,944)	590	(15,329)	(41,116)	2,177	3,521	13,735	39,409	83,473

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## FINANCIAL RATIOS

	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>Performance Statistics (%)</b>									
Return on Total Assets	(3.6)	0.1	(4.0)	(10.7)	0.5	0.7	2.0	4.2	6.7
Return on Earning Assets	(3.7)	0.2	(4.1)	(10.9)	0.5	0.7	2.1	4.3	6.9
Return on Average Equity	(6.0)	0.3	(6.1)	(14.9)	0.7	1.0	3.2	7.5	12.6
Interest Coverage Ratio	(1.2)	1.1	(1.3)	(19.4)	1.7	2.2	3.6	3.7	4.6
<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	13,943
Non-Accruals as % Gross Loans Out.	12.0	15.0	30.2	23.2	16.9	18.8	11.8	4.6	1.7
Non-Accruals as % Loan Loss Res.	131.2	166.0	273.6	136.6	114.5	141.4	107.0	71.9	35.3
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	0.7
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	0.4
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	11.0
<b>Liquidity Ratios (%)</b>									
Liquid Assets/Total Assets	10.0	16.3	14.2	20.1	19.9	22.5	30.7	27.7	33.0
Liquid Assets/Total Borrowings	24.1	40.1	51.4	91.3	106.2	137.2	106.2	76.0	82.2
<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	59.7
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	91.2
Borrowings Outstanding as % Subscr. Cap. + Accum. Earn.	71.9	24.0	15.6	13.3	12.4	12.3	29.2	48.1	62.9
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	5.9

[1] PIC equals Paid-in Capital

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Ten Largest Exposures in the Outstanding Portfolio by Country of Domicile (US\$ Thousands as of December 31, 2007)

	Loan	Equity	Total	%
Colombia	145,264	429	145,693	17.3
Brazil	144,841	-	144,841	17.2
Chile	90,523	4,136	94,659	11.3
Mexico	54,656	7,685	62,341	7.4
Peru	116,144	-	116,144	13.8
Ecuador	38,974	-	38,974	4.6
El Salvador	21,194	-	21,194	2.5
Costa Rica	32,036	-	32,036	3.8
Uruguay	14,559	334	14,893	1.8
Nicaragua	34,506	-	34,506	4.1
Ten Largest Exposures [1]	692,697	12,584	705,281	84.0
Total	796,910	43,017	839,927	100.0

[1] The Corporation also has a \$62 million (7.3% 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 2007)

	Capital Shares	Subscribed Capital %
United States	176,000	25.0
Argentina	77,670	11.0
Brazil	77,670	11.0
Mexico	50,000	7.1
Venezuela	43,110	6.1
Spain	23,930	3.4
Japan	23,930	3.4
France	21,620	3.1
Italy	21,620	3.1
Chile	20,030	2.8
Ten Largest Shareholders	535,580	76.1
Total	703,700	100.0

## Inter-American Investment Corporation

## Moody's Related Research

## Credit Opinion:

- Inter-American Investment Corporation

## Analysis:

- Inter-American Investment Corporation, March 2007

## 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 Methodologies:

- 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 of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

Report Number: 108298

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