



Rating_Action: Moody's affirms the Arab Bank for Economic Development in Africa's rating at Aa2, outlook remains positive

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London, March 09, 2023 – Moody's Investors Service ("Moody's") has today affirmed the Arab Bank for Economic Development in Africa's (BADEA) foreign currency long-term issuer rating at Aa2. The outlook remains positive.

The decision to affirm BADEA's Aa2 rating reflects the bank's very strong capital adequacy supported by its very strong capital position as well as improved asset performance. Also, the introduction of \$5 billion callable capital in 2022 combined with the conversion of \$800 million of reserves into paid-in capital further support a high strength of member support. Lastly, BADEA has a robust liquidity position, although this has declined from the extremely high levels of 2021.

The continuing positive outlook reflects the prospect of BADEA strengthening its liquidity buffers again, realising its planned issuance in the capital markets, while maintaining its strong asset performance, all of which could support a higher rating level.

RATINGS RATIONALE

RATIONALE FOR THE AFFIRMATION

STRONG CAPITAL ADEQUACY SUPPORTED BY LOW LEVERAGE AND IMPROVED ASSET PERFORMANCE

The first driver supporting the decision to affirm BADEA's rating at Aa2 is the institution's very low leverage and improved asset performance. The bank is one of the least leveraged among Moody's rated multilateral development banks (MDBs), at 0.8x at end-2022. This compares to leverage ratios typically between 2.5-3x for Aa- and Aaa-rated MDBs. BADEA's exceptionally strong capital position is unlikely to change in the future given the prudent loan growth anticipated in its five-year strategic plan 2020-2024, with the bank's leverage ratio likely to remain below 1x over the period.

In 2022, BADEA's ratio of nonperforming assets to development-related assets continued to fall to 0.7% from 2.4% in 2021 and 4.7% in 2020. This result was achieved despite a very challenging economic and financial environment in Sub-Saharan Africa (SSA) which suffered from the food and energy price shock as well as deteriorating global financial conditions after the negative impact of the pandemic. While the risk of more countries facing debt distress rises, Moody's expects that the bank's asset performance is likely to remain strong and aligned with Aa2-rated peers due to the bank's sustained efforts to strengthen its risk management policies, but also because of the highly concessional nature of its loans and the diversification of its portfolio.

BADEA has been a profitable institution for most of its 49 years in existence. However, in 2022, BADEA posted a net loss of \$187 million, driven by \$257 million loss in investment income mostly due to unrealized losses in its hold to maturity portfolio. Moody's expects BADEA to

return to profitability in 2023 and to remain profitable over the medium term. BADEA's extremely strong capital position has allowed the Bank to provide highly concessional loans for decades without borrowing funds while significant profits were mainly derived from the management of its large treasury assets. Over the last 20 years, the Bank's average net income was \$126 million per annum. BADEA has constantly strengthened its capital position by systematically allocating its profits to general reserves since it does not distribute any dividend.

STRONG LIQUIDITY POSITION SUPPORTED BY LARGE STOCK OF LIQUID ASSETS, ALBEIT WEAKER THAN IN 2021

The second driver supporting the affirmation of the Aa2 rating is BADEA's ample liquidity. At the end of 2022, liquid assets held by BADEA amounted to \$2.6 billion, of which Moody's only includes around 45% in its calculation of its key liquidity metric, which compares highly rated liquid assets to the sum of net cash outflows in the coming 18 months.

The ratio remains strong overall despite its significant decline to 126% in 2022 compared to extremely high levels of 405% in 2021. In Moody's view, the decline in the liquidity ratio will likely be reversed since it has been due to a combination of high loan disbursements related to both clearing of pandemic-deferred lending and trade finance operations in the context of food and energy price shocks in BADEA's countries of operation in Africa as well as the above-mentioned valuation losses in the investment portfolio. BADEA plans to issue its first bond in the global capital markets in 2023, which should help it to replenish its liquidity buffers.

HIGH STRENGTH OF MEMBER SUPPORT EVIDENCED BY A NEW GENERAL CAPITAL INCREASE AND THE INTRODUCTION OF CALLABLE CAPITAL

The third driver for affirming the Aa2 rating is BADEA's high shareholder support, evidenced by the introduction of callable capital last year. BADEA's shareholders increased its subscribed capital to \$10 billion, with the introduction of \$5 billion in callable capital. It also included an increase in paid-in capital to \$5.0 billion from \$4.2 billion after the transfer of \$800 million from reserves. Until this decision, BADEA did not benefit from callable capital or other contractual forms of support. Against the background of BADEA's intention to raise debt in the markets this year, the callable capital will act as a last line of defense for creditors in the remote scenario where the MDB faces difficulties in repaying its debt. The Bank's shareholders include several highly rated sovereigns such as Saudi Arabia (A1 stable), the United Arab Emirates (Aa2 stable), Kuwait (A1 stable) and Qatar (Aa3 positive) which together hold 61% of the Bank's capital.

The high member support is also supported by the fact that BADEA plays a leading role through the Arab Coordination Group, which comprises all of the leading Arab development institutions and by collaborating with other MDBs in the co-financing of projects. It acts as the catalyst for Arab investment in the African continent. For example, the bank estimates that it generated \$5 in additional lending for each dollar it allocated to the public sector in 2022. Also, BADEA's level of connections, through its highest authority the Board of Governors, could be useful in case of financial support needs. It is usually constituted from the ministers of finance of respective member countries.

RATIONALE FOR THE POSITIVE OUTLOOK

The positive outlook reflects Moody's view that a continuing improvement in BADEA's credit fundamentals would support a higher rating over the next 12-18 months. The prospects of BADEA successfully implementing its 5-year plan 2020-2024 while maintaining very strong liquidity and capital adequacy levels will support its credit profile. BADEA's robust liquidity position has diminished compared to the extremely high levels of 2020-2021; the prospect of

BADEA restoring its liquidity buffers to exceptionally strong levels could support a higher rating level. BADEA is likely to be successful in establishing its market presence, given its strong financial metrics. Meanwhile, the bank's capital buffers are likely to remain very high to compensate for risks from the nature of the bank's lending activity in Sub-Saharan Africa. Also, the further consolidation of the significant improvements of BADEA's asset performance would also support the rating over the coming years.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

BADEA's credit impact score is neutral-to-low (CIS-2) reflecting neutral-to-low exposures to social and governance risks as well as moderately negative exposures to environmental risks due to countries' exposition to physical climate and carbon transition risks.

BADEA's moderately negative exposure to environmental risk (E-3 issuer profile score) reflects its regional concentration with many of its borrowers and a number of its largest shareholders highly exposed to physical climate and carbon transition risks. This is balanced by very good diversification of the lending portfolio across countries in non-carbon intensive sectors and environmental projects in line with global MDB standards.

BADEA's social issuer profile score is neutral to low (S-2 issuer profile score), underpinned by the Bank's strong relationships with its sovereign borrowers given its policy role in promoting trade and development, and its solid reputation in member countries. BADEA benefits from being the Arab countries' main window to structure and help channel Arab investments in the African continent.

BADEA's governance issuer profile score is neutral-to-low (G-2 issuer profile score). This reflects the Bank's strong compliance and reporting standards and credible management practices, with improving financial strategy and risk management reflected in declining non-performing loans despite low-rated borrowers.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

Moody's would consider upgrading BADEA's rating to Aa1 if the bank managed to rebuild very strong liquidity buffers while maintaining a strong level of asset performance and capital position. Additionally, an established track record of frequent market access would also exert positive pressure on the rating.

A downgrade over the next 12 to 18 months is unlikely given the positive outlook. Moody's would likely change the outlook to stable if it concludes that BADEA's asset performance improvements were to stop or reverse. This would ultimately weaken Moody's assessment of BADEA's capital adequacy. Failure to restore liquidity to the previous exceptionally strong levels would be consistent with the rating remaining at Aa2. Finally, if leverage were to rise significantly from present levels or if there were indications of declining shareholder support for BADEA, this would also exert downward pressure on the Aa2 rating.

The principal methodology used in this rating was Multilateral Development Banks and Other Supranational Entities Methodology published in October 2020 and available at <https://ratings.moodys.com/api/rmc-documents/69182>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

The local market analyst for this rating is Aurelien Mali, +971 (423) 795-37.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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