MOODY'S
RATINGS

Rating Action: Moody's Ratings upgrades the Arab Bank for Economic Development in Africa's ratings to Aa1; changes the outlook to stable

21 May 2024

London, May 21, 2024 -- Moody's Ratings ("Moody's") has today upgraded the Arab Bank for Economic Development in Africa's (BADEA) foreign currency long-term issuer and senior unsecured ratings to Aa1 from Aa2. Moody's has also upgraded the foreign currency senior unsecured MTN programme rating to (P)Aa1 from (P)Aa2. The outlook has been changed to stable from positive.

The decision to upgrade reflects BADEA's robust capital adequacy, bolstered by an enhanced capital position and improved asset performance, despite the challenging environment in Sub-Saharan Africa (SSA). Furthermore, BADEA's liquidity position has seen a significant improvement, evidenced by the successful recovery of its substantial liquidity buffers, which have been further strengthened by a successful capital market issuance. Finally, BADEA continues to play a pivotal role in directing Arab investment towards the African continent which explains the high level of shareholders' support it receives. This support was again demonstrated by the formalisation of the $5 billion callable capital increase granted in 2022.

The stable outlook reflects Moody's expectations that BADEA's strong capital and liquidity position will remain robust. Moody's also expects that the bank will maintain strong asset performance metrics, notwithstanding the weak operating environment in many of its countries of operation.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE AT Aa1

STRONG CAPITAL ADEQUACY AS REFLECTED IN A COMBINATION OF LOW LEVERAGE AND IMPROVING ASSET PERFORMANCE

The decision to upgrade BADEA's rating reflects the bank's strengthened capital adequacy, which was already at strong levels. Leverage is low and combines with an improving trend in its non-performing loans, despite the weak credit quality of its exposures. BADEA's leverage ratio has remained stable at 0.7x despite the fact that the bank's Development Related Assets (DRA) have significantly increased over the last three years from $2.2 billion to $3.2 billion, growing at an annual pace of 16.2% on average. BADEA's extraordinarily solid capital position is also projected to remain stable, given the bank's strategic plan for moderate asset growth in the coming years. Finally, BADEA's long-standing history of profitability, reaching $292 million in 2023, will continue to fortify the bank's usable equity. The bank has consistently channeled its profits into its general reserves as retained earnings, without ever distributing any dividends, and plans to maintain this practice.

The performance of the bank's asset portfolio continues to improve despite the weak credit quality of its development assets. The trend of declining non-performing assets (NPAs) that started in 2016 has persisted, with the bank's NPA ratio falling to 0.51% at the end of 2023, down from 0.64% in 2022 and 20.8% in 2016. The improvement in BADEA's asset performance comes despite the numerous defaults that have occurred in SSA, a region still facing challenging economic and financial conditions and susceptible to political instability. The strength of BADEA's capital, the high diversification of its portfolio as well as very concessional nature of its lending mitigate the risks stemming from overall weak borrower credit quality. BADEA has also successfully leveraged its preferred creditor status and continues to strengthen its risk management framework. Borrowers typically find it more manageable to stay current on their obligations to BADEA, primarily due to the bank's typically larger disbursements compared to payments due. This is facilitated by BADEA's provision of some of the most cost-effective loan options among multilateral development banks (MDBs). Finally, accumulating arrears to BADEA not only results in the freeze of lending from BADEA but it also affects lending coming from the Arab Coordination Group (ACG), further incentivizing borrowers to remain current on repayments to BADEA.

BADEA'S STRONG LIQUIDITY POSITION HAS SIGNIFICANTLY IMPROVED

The second driver supporting the decision to upgrade the rating to Aa1 is BADEA's robust liquidity position that has significantly strengthened due to the improved credit quality of its treasury asset portfolio and the issuance of a €500 million eurobond in January 2024. At the end of 2023, BADEA had liquid assets worth $2.6 billion, equating to 42.7% of total assets.

To assess the liquidity available, Moody's considers highly rated liquid assets relative to net cash outflows over the coming 18 months. By pursuing the sale of its global listed equity holdings and significantly increasing its share of highly rated fixed income instruments, BADEA's liquidity ratio improved to 190.7% in 2023 from 125.9% in 2022, and peaked near 250% when factoring in the proceeds of the eurobond issuance.

Moody's expects the bank to gradually expand its presence on the international financial markets to bolster its strong liquidity metrics and fund the growth of its operations. That said, the high profitability of BADEA in part derived from its treasury assets will continue to cover a significant part of its annual net cash requirements limiting the need for significant borrowings in the future.

HIGH STRENGTH OF MEMBER SUPPORT AFFIRMED WITH THE FORMALISATION OF CALLABLE CAPITAL INCREASE

The third driver for the upgrade to Aa1 reflects the continuous high shareholder support from which BADEA benefits. In 2023, the bank's articles of establishment were revised to formally include the $5 billion in callable capital agreed in 2022, along with its associated modalities. In 2022, BADEA's shareholders unanimously decided to increase the bank's capital by injecting $800 million dollars into paid-in capital, which reached $5 billion and added $5 billion of callable capital. Callable capital is a contractual obligation of shareholders, and indicates a strong willingness to provide support if it ever was needed. In BADEA's case, shareholders rated A3 and above hold 61% of the shareholding, with the primary shareholders being members of the Gulf Cooperation Council (GCC).

At the Arab-Africa summit held in 2023, in Saudi Arabia, the Arab Coordination Group, a consortium of leading Arab development institutions, collectively pledged $50 billion towards Africa by 2030. BADEA, being the Chair of the AGC forum for this initiative, will play an integral role as a catalyst in underwriting and disbursing the loans. This role strengthens BADEA's importance and relevance for its shareholders and cements BADEA's position as the Arab center of excellence and expertise concerning the African continent, with strong relationships with all the SSA countries.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectations that BADEA's strong capital and liquidity position will remain robust and, in particular, the bank will maintain strong asset performance metrics. Additionally, since the bank continues to gradually reduce its holdings in listed global equity, the volatility of its treasury asset portfolio will also decrease, leading to a more stable performance. Downside risks are primarily associated with the comparatively challenging operating environment in Sub-Saharan Africa and the bank's borrowers weak credit quality overall. However, BADEA has leveraged its preferred-creditor status and enhanced risk management framework to avoid any write-offs so far. The stable outlook also encapsulates Moody's anticipation that BADEA's shareholders will continue to provide substantial support.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

BADEA's CIS-2 credit impact score indicates ESG considerations do not substantially influence the bank's current rating. This conclusion is based on Moody's assessment of the bank's limited exposures to social and governance risks, notwithstanding moderate exposure to environmental risks.

BADEA's moderate environmental exposure (E-3) is driven by its regional concentration, with a significant portion of its largest shareholders, in particular the GCC countries, being greatly 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.

BADEA's social issuer profile score is neutral to low (S-2), 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). 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 RATINGS

An upgrade to Aaa is unlikely over the medium term, even if BADEA's financial profile strengthens further and the average credit quality of the bank's borrowers was to improve significantly. Aaa-rated MDBs generally benefit from very strong shareholder support, are big lenders with development impact and have very strong funding franchises. While BADEA continues to maintain a very strong liquidity and capital adequacy, supported by solid asset performance, it is still building its presence on the international markets.

Moody's would consider downgrading BADEA's rating if there were a substantial and prolonged decline in the bank's capital adequacy or liquidity metrics. This could, for example, be triggered by a deterioration in the bank's asset performance, which might ultimately result in substantial losses on the bank's loan portfolio. The rating could also come under pressure if leverage were to significantly increase from present levels without commensurate strengthening of risk management and operational capabilities or if there were indications of waning shareholder support for BADEA.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities published in February 2024 and available at https://ratings.moodys.com/rmc-documents/414557 . 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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