

**Rating Action: Moody's assigns first-time Aa2 rating to the Arab Bank for Economic Development in Africa, with a positive outlook**

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London, 18 February 2022 -- Moody's Investors Service ("Moody's") has today assigned a Aa2 foreign currency long-term issuer rating to the Arab Bank for Economic Development in Africa (BADEA) and has also assigned a positive outlook.

The main factors underpinning BADEA's Aa2 rating are:

1. A very strong capital position and low leverage, notwithstanding the relatively weak credit quality of the bank's loan portfolio.
2. An extremely high level of liquid resources supported by prudent liquidity management and policies. The bank has no debt but plans to access international capital markets going forward.
3. A high level of member support from its shareholders despite the absence of contractual support.

The positive outlook reflects Moody's view that a continuing improvement in BADEA's asset performance would likely support a higher rating in the future given improved risk management practices and arrears policy. Asset performance more in line with higher-rated Multilateral Development Banks (MDBs) would also support a higher rating level.

**RATINGS RATIONALE**

**RATIONALE FOR THE Aa2 RATING**

**VERY STRONG CAPITAL POSITION AND LOW LEVERAGE MITIGATE LOW ASSET QUALITY OF ITS LOAN PORTFOLIO**

BADEA has very solid capital buffers, standing at \$5.4 billion as of end-2020, the last year for which audited financial statements are available. Useable equity is comprised of \$4.2 billion of subscribed and fully paid-in capital, and \$1.2 billion of reserves. BADEA has constantly strengthened its capital position by systematically allocating its profits to general reserves since it does not distribute any dividend.

BADEA's leverage -- defined as the sum of development-related assets (\$2.1 billion as of end-2020) and its treasury assets rated A3 or lower (\$1.7 billion) over useable equity of \$5.4 billion -- stood at 0.7x at the end of 2020. It is one of the lowest among Moody's rated MDBs and a key strength of BADEA's credit profile. 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.

By design, BADEA's loan portfolio is entirely located in the Sub-Saharan Africa (SSA) region since the Bank's shareholders are excluded from its direct operations. This results in a relatively low asset quality of the Bank's loan portfolio. At the same time, the loan portfolio is highly diversified; loan amounts are typically between \$20-\$25 million, with highly concessional terms and interest rates between 1-2% and very long maturities (25 years on average). 88% of the portfolio consists of loans to sovereigns, with the remainder allocated to private-sector borrowers.

The Bank's loan growth has been around 6% CAGR between 2016-2020 and the Bank targets a similar growth rate for the coming years. It also aims to increase the share of loans extended to the private sector, to 20% of the total loan portfolio by the end of 2024 from 12% in 2020. Moody's typically associates private-sector exposures with a weaker credit quality and higher asset risks than sovereign exposures. However, in BADEA'S case, its private sector loans tend to have stronger asset quality since more than 60% are exposed to investment grade counterparties.

Assuming the implementation of its 5-year business plan 2020-2024 is realized with annual net loan

commitments of \$350 million and an unchanged credit quality allocation of its treasury assets, BADEA's leverage ratio is likely to remain below 1x over the next 5 to 10 years and will therefore continue to compare favourably to the average leverage ratios for Aaa and Aa-rated MDBs which were close to 3x and 2.2x respectively at the end of 2020.

Also, BADEA's asset performance has been improving for several years, with the ratio of non-performing assets (NPAs) to development-related assets falling to 2.6% in 2021 (as per the unaudited financial accounts), from 5.9% in 2019. These improvements are the result of improved and more stringent risk management policies put in place since 2015 -- the year BADEA decided to develop a private sector portfolio.

#### LIQUIDITY POSITION IS EXTREMELY STRONG AND WILL SUPPORT MARKET ACCESS

BADEA benefits from an extremely strong liquidity position, ranking above most Aaa-rated and Aa-rated peers in terms of its share of liquid assets (above 60% of total assets). The stock of its liquid assets is extremely robust, both relative to BADEA's balance sheet and planned disbursements. At the end of 2020, BADEA's treasury portfolio reached \$3.3 billion which amply exceeds the size of its existing loan portfolio at \$2.1 billion. The majority of the treasury holdings are highly liquid and diversified, comprising highly rated fixed income securities. As of the end of 2020, the ratio of liquid assets rated A2 or higher (\$1.8 billion) to 18 months of net cash outflows stood at almost 10 times, the highest among all rated MDBs. This means that the bank's liquid assets could easily cover its operations for around 15 years without accessing the capital markets, assuming unchanged levels of net cash outflows.

Additionally, BADEA's liquidity risks are limited because the bank has no debt outstanding. Its liquidity needs, equivalent to its net cash requirements (NCR), include its net loan outflows plus administrative expenses. They generally average between \$120 and \$150 million each year and are mostly covered by BADEA's net income that averaged \$137 million over the last 20 years. Income is mainly generated by the returns on its large treasury portfolio, given that loans are extended on highly concessional terms.

So far, BADEA has not relied on market funding given its very large capital buffer. The Bank plans to gradually build a small presence in international capital markets, in particular to fund some euro-denominated operations in west and central Africa. In Moody's view, its very strong capital and liquidity metrics will support its ability to access markets.

#### HIGH STRENGTH OF MEMBER SUPPORT DESPITE THE ABSENCE OF FORMAL CONTRACTUAL SUPPORT

The third driver for the Aa2 rating is the strong support from shareholders, who consider BADEA as the main gateway and catalyst to help coordinate the deployment of Arab development funds in SSA. 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 stable) which together hold 61% of the Bank's capital.

BADEA plays a leading role in channeling Arab investment in the African continent. This is also done through the Arab Coordination Group (ACG) which comprises all of the leading Arab development institutions and by collaborating with other MDBs in the co-financing of projects. BADEA's highest authority is the board of Governors which is usually constituted by the ministers of finances of their respective countries. Yet, the management of the Bank is vested primarily in the Board of Directors composed of eleven members who are also generally prominent public officials with experience in economic development. This level of connections could be useful in the unlikely case of financial support needs.

Moody's key indicator for the ability of shareholders to provide support to an entity in case of need is the weighted average shareholder rating which in BADEA's case stands at "Ba2", being skewed lower by the presence of unrated or lowly rated shareholders such as Iraq (Caa1 stable), Libya, Algeria, Tunisia (Caa1 negative) and Lebanon (C, No outlook) which hold a combined 35% share of the Bank. However, Moody's believes that shareholders have a stronger ability and willingness to support the Bank than the quantitative metric suggests.

Specifically, BADEA's shareholders have provided the Bank with a very large capital injection at inception and further embarked on a five-year capital injection plan in 2013. BADEA's paid-in capital reached to \$4.2 billion in 2019 from \$2.8 billion in 2013, following a \$700 million transfer from the general reserves in 2014 and annual capital injections from its shareholders averaging \$100 million till 2019.

BADEA does not benefit from callable capital or other contractual forms of support. However, BADEA has no

outstanding debt and very large liquid assets, which diminishes the relevance of callable capital as a last line of defense for bondholders in a scenario where an MDB faces difficulties to pay its debt. Moody's also notes that BADEA's very low leverage reduces the risk of BADEA facing a financial distress situation that would require an emergency capital infusion.

#### RATIONALE FOR THE POSITIVE OUTLOOK

The positive outlook reflects Moody's view that a continuing improvement in BADEA's asset performance would support a higher rating in the future. In the 48 years since its inception, the bank has never crystallized credit losses or written off a loan but has historically had relatively high levels of non-performing assets (NPAs). Since 2016, the Bank has changed its risk management practices and arrears policy, resulting in a continuous reduction in its NPA ratio to 4.8% at the end of 2020 from 20.8% in 2016. The prospect of continued improvement in the coming years would bring BADEA's asset performance more in line with higher-rated MDBs. BADEA is likely to be successful in establishing its market presence, given its strong financial metrics.

#### ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

BADEA's credit impact score is neutral-to-low (CIS-2) reflecting moderately negative exposures to environmental risks and neutral-to-low exposures to social and governance 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

Further upside rating potential on BADEA's rating could appear if the bank continues to improve and sustain a strong level of asset performance while also developing its private sector initiative, while maintaining its strong capital and liquidity positions. Stronger contractual support metrics or an established track record of strong 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 were to conclude that BADEA's asset performance improvements were to stop or reverse. This would ultimately weaken Moody's assessment of BADEA's capital adequacy. Although unlikely, a significant erosion of BADEA's liquidity buffers or its capital base would also likely lead Moody's to change the outlook to stable. 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 upon the Aa2 rating.

#### ISSUER PROFILE

The Arab Bank for Economic Development in Africa (BADEA) is a multilateral development bank (MDB) created by 18 governments of the Arab League States (LAS) in 1974 which own the entire capital of the Bank, and is headquartered in Khartoum, Sudan.

The Bank's main objective is to foster economic, financial, and technical cooperation between Sub-Saharan African (SSA) countries and Arab countries. BADEA's charter prohibits lending to its shareholders and within its shareholders' jurisdictions. Therefore, all its lending operations are in Sub-Saharan African countries. To achieve its objective, BADEA was mandated to (i) participate in financing economic development in African countries; (ii) stimulate the contribution of Arab capital in African development; and (iii) participate in providing the technical assistance required for development in Africa. BADEA benefits from all the usual privileges and immunities seen in other MDBs.

The principal methodology used in this rating was Multilateral Development Banks and Other Supranational Entities Methodology published in October 2020 and available at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1232238](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1232238) . Alternatively, please see the Rating Methodologies page on [www.moodys.com](http://www.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 at: [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_79004](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004).

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