



## RATING ACTION COMMENTARY

# Fitch Affirms Afreximbank at 'BBB-'; Outlook Stable

Fri 11 Sep, 2020 - 2:30 PM ET

Fitch Ratings - London - 11 Sep 2020: Fitch Ratings has affirmed African Export-Import Bank's (Afreximbank) Long-Term Issuer Default Rating (IDR) at 'BBB-' with Stable Outlook. Fitch has also affirmed the bank's Short-Term IDR at 'F3' and senior unsecured debt at 'BBB-'.

## KEY RATING DRIVERS

Afreximbank's 'BBB-' rating is driven by the bank's intrinsic features, including solvency and liquidity, both assessed at 'a-'. Despite the pressure on asset quality resulting from the COVID-19 crisis, the ongoing and expected capital increases support the resilience of the bank's solvency. The 'high risk' business environment in which the bank operates translates into a three-notch negative adjustment to our assessment of the bank's solvency and liquidity, resulting in an intrinsic assessment of 'bbb-'.

Afreximbank's solvency assessment of 'a-' reflects its 'strong' capitalisation and 'moderate' risk profile.

The 'strong' capitalisation is underpinned by the equity to assets and guarantees ratio, at 18.1% in 2019, close to 2018 level (18.5%) as the bank's expansion has been broadly matched by paid-in capital payments from the ongoing USD1 billion capital increase (targeted to be completed by end-2021, 91% had been raised by end-1H20) and internal

capital generation. Fitch's usable capital to risk-weighted assets (FRA) was 21% in 2019 (from 20% in 2018), consistent with a 'moderate' assessment (15%-25%).

Fitch expects the equity-to-assets and FRA ratios to decline in the coming years as the impact of the COVID-19 crisis on asset quality affects internal capital generation and the bank accelerates loan disbursement in the short-term in response to the crisis. Fitch expects the growth in loans to average close to 20% in 2020-2022. However, the bank's capitalisation metrics should remain consistent with a 'strong' assessment by the end of 2022. This assumes continuing payments under the USD1 billion capital increase and the start of payments under a new USD500 million capital increase, approved in June this year.

The Bureau of African Union Heads of States and Governments recently endorsed a significant increase to the bank's subscribed capital. Fitch understands that the final approval of this capital increase could take place at the bank's Annual General Meeting in 2021, and the first paid-in capital payments would start shortly thereafter. In Fitch's view, this capital increase would support the resilience of the bank's solvency, despite the negative impact of the COVID-19 crisis on asset quality.

In March 2020, the bank's Board of Directors approved USD3 billion net Pandemic Trade Impact Mitigation Facility (PATIMFA) to assist its member states in addressing economic and health impacts of the pandemic crisis. The approved package represents a reallocation of existing resources. The policy response will lead to acceleration of loan approvals and disbursements, primarily to sovereign borrowers.

Fitch assesses Afreximbank's overall exposure to risks as 'moderate', balancing its 'high' credit risk profile and 'moderate' risk management policies against its 'low' concentration risk and 'very low' equity and market risks.

Fitch has revised its assessment of the bank's credit risk to 'high' from 'moderate', due to the expected deterioration in the credit quality of the banking portfolio as the result of the COVID-19 crisis. The agency expects the average rating of the bank's loan portfolio before accounting for credit risk mitigants to decline to 'CCC' over the medium term from 'B-' as of end-2019. Since the start of the crisis, Fitch has downgraded four countries (Gabon (CCC), Kenya (B+/Negative), Nigeria (B/Negative) and Zambia (CC)), which account for 41% of the bank's country exposure. In addition, 40% of loans are extended to entities based in countries where the sovereign rating currently has a Negative Outlook (Cameroon (B), Ethiopia (B), Kenya, Namibia (BB), Nigeria, South Africa (BB), Uganda (B+) Lesotho (B)), pointing to further pressure on the rating of the bank's loan book.

The use of various credit risk mitigants, including the high level of loan collateralisation (88% of the facilities), credit insurances from 'A' rated insurers and hedging strategies on commodity backed facilities, has helped the bank maintain a low impairment ratio historically (2.4% on a 10-year average), despite its 'high' risk operating environment. Fitch accounts for the use of credit risk mitigants used by the bank via an uplift of three notches above the average rating of loans to 'B+' by 2022. Nonetheless, Fitch expects that the economic impact of the pandemic will lead to a marked decline in the performance of loans.

Non-performing loans (NPL), as reported by the bank, increased to 3.5% of gross loans as of end-1H20 from 2.8% in 2019 (and 3% in 2018), driven by non-sovereign NPLs. Stage 3 loans, closer to Fitch's own definition of NPLs, remained at 4% of total loans during this period. Fitch expects NPLs and Stage 3 loans will increase markedly in the short term, driven by weaker performance in the non-sovereign portfolio (that account for 69% of the loan book). The agency forecasts an increase in the ratios of NPLs and Stage 3 loans to a 'high' level (more than 6%) by end-2022. In Fitch's view, loans in the hospitality, construction, agriculture, transportation and manufacturing sectors, which together accounted for 18% of gross exposure as of end-1H20, are particularly exposed to the current crisis.

The agency does not expect impairment on the bank's sovereign exposures. The PATIMFA, which supports net positive inflows to sovereigns, will provide strong incentives for sovereigns to remain current with the bank. Nonetheless, non-performing sovereign exposure is a downside risk to the forecast.

Concentration risk is 'low', with the bank's five largest exposures accounting for 26% of total banking portfolio at end-2019. The 'very low' assessment of market risk reflects the bank's use of derivative instruments in managing FX and interest rate risks and short-term tenure of its trade finance facilities. The 'moderate' risk management policies primarily reflect the use of credit risk mitigants that have helped maintain a relatively low NPL ratio, despite the high-risk environment in which the bank operates.

Fitch assesses the bank's liquidity at 'a-'. Liquid assets, including discounted trade finance loans, were 1.1x short-term debt at end-2019 and Fitch expects the liquidity ratio to fall below 100% by end 2022, consistent with a 'moderate' assessment. A large portion of the bank's short-term debt is made of deposits held as collateral for loans extended to central banks. The agency expects the bulk of these deposits to be rolled over at maturity. The quality of liquid assets is deemed 'moderate', with the share of the treasury assets rated 'AA' to 'AAA' 31% of the total in 2019. The bank's liquidity profile is enhanced by access to

additional liquidity sources, including credit lines and deposits, and the short duration of the loan portfolio.

Afreximbank's business environment is deemed 'high risk', primarily reflecting its strategy, characterised by a rapid growth of its banking operations in high risk countries. This assessment also reflects the low per capita income and high political risk in the countries of operations, including Egypt (B+/Stable), where the bank is headquartered.

Fitch assesses Afreximbank's support rating at 'bb', unchanged from the previous review. The average rating of key shareholders fell to 'BB-' following the change in the bank's shareholder base and the recent downgrade of Nigeria, the largest shareholder. The bank's callable capital is partially supported by medium-term credit risk mitigants, which provides a one-notch uplift over the bank's shareholders' average credit quality, leading to 'bb' support capacity. Fitch has revised the bank's shareholders' propensity to support to 'strong' from 'moderate' previously. This reflects regular inflows of fresh capital and the recent endorsement for a significant increase to the bank's subscribed capital. The strong propensity results in a support assessment of 'bb'.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Solvency (capitalisation): an improvement in capitalisation metrics stemming from a marked increase in paid-in capital or weaker-than-expected growth in the bank's balance sheet.

Solvency (risks): strengthening in the credit risk profile of the bank via improvement in the credit quality of the loan and guarantee portfolio and a decline in the NPL ratio.

Liquidity: higher coverage of short-term debt by liquid assets and improvement in the share of 'AA'-'AAA' rated treasury assets.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Solvency (capitalisation): weakening in our assessment of capitalisation metrics, which could occur due to higher-than-projected lending growth or loan losses, or weaker-than-expected capital increase. This would be the case if the approval and paid-in disbursement

under the newly endorsed capital increase were delayed relative to our expectation and/or if the size of this capital increase fell below our expectation.

**Solvency (risk):** Worst-than-expected deterioration in asset quality and loan performance, for example stemming from further downgrades of African sovereigns and higher-than-anticipated NPLs.

**Liquidity:** deterioration in Fitch's assessment of liquidity, which could result from weaker coverage of short-term debt by liquid assets, decline in the share of 'AA'-'AAA' rated treasury assets, or deterioration in access to capital markets and other source of liquidity.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>].

## **KEY ASSUMPTIONS**

The global economy will develop in line with Fitch's Global Economic Outlook published on 7 September 2020, including a deep but short-lived recession in 2020 due to the pandemic. There is an unusually high level of uncertainty around these forecasts and risks are firmly to the downside.

Fitch assumes that the significant capital increase endorsed by the Bureau of African Union Heads of State and Government in August 2020 will be approved by the bank's shareholders in 2021. The agency further assumes that paid-in capital disbursements under this new capital increase will start from 2021.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

### RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
African Export-Import Bank (Afreximbank)	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
●	ST IDR	F3	Affirmed	F3
● senior unsecured	LT	BBB-	Affirmed	BBB-

[VIEW ADDITIONAL RATING DETAILS](#)

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## **APPLICABLE CRITERIA**

[Supranationals Rating Criteria \(pub. 30 Apr 2020\) \(including rating assumption sensitivity\)](#)

## **ADDITIONAL DISCLOSURES**

[Dodd-Frank Rating Information Disclosure Form](#)

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## **ENDORSEMENT STATUS**

African Export-Import Bank (Afreximbank)

EU Issued

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Supranationals, Subnationals, and Agencies

Africa

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Europe

Egypt

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