MOODY'S RATINGS

Rating Action: Moody's Ratings changes AFC's outlook to stable, affirms A3 ratings

24 Sep 2024

New York, September 24, 2024 -- Moody's Ratings (Moody's) has changed the outlook on the Africa Finance Corporation (AFC or the corporation) to stable from negative and has affirmed AFC's long-term foreign currency issuer and senior unsecured ratings at A3, as well as AFC's short-term foreign currency issuer rating at P-2. Concurrently, we have also affirmed the corporation's provisional long-term foreign currency senior unsecured MTN program rating at (P)A3 and the other short-term foreign currency program rating at (P)P-2.

The change in outlook to stable from negative is driven by our expectation that AFC will be able to maintain stable or improving leverage and that the asset performance track record will be preserved. The improved leverage outlook compared to trends up to 2021 reflects the corporation's strong equity raising strategy. The bank exceeded its $1 billion target in 2019-23, and aims to continue raising equity capital during 2024-28. Moreover, the corporation lowered its dividend payout ratio starting 2023 which will help retain a higher share of earnings and grow the capital base organically in the future. Notwithstanding increased country risk in several of AFC's countries of operation over the past year, asset performance has proven resilient amid effective credit protections. The stable outlook also reflects management's governance track record and early intervention capacity to mitigate materializing risks at an early stage.

The A3 rating affirmation reflects the corporation's adherence to its prudential guidelines to safeguard the institution's intrinsic financial strength based on solid capital adequacy and high-quality liquidity buffers, commensurate with the corporation's equity investments and private sector exposures in high country-risk areas.

RATINGS RATIONALE

RATIONALE FOR THE STABLE OUTLOOK

LEVERAGE OUTLOOK IMPROVES AMID CONTINUED EQUITY RAISING EFFORTS

Following several years of deterioration, we expect the leverage ratio to level out within the 3x-3.5x equity range. That compares to the median of A-rated peers of between 1x-1.5x. The corporation is now operating within, but closer to, its prudential leverage limit of 30% Basel CAR, limiting the room for operations expansion to the pace of equity accumulation.

After peaking at 3.6 times equity in 2021, our calculation of AFC's leverage ratio (defined as development-related assets, including loans + equity exposures + guarantees, in addition to treasury assets rated A3 and below, divided by usable equity) eased back to 3.3x in 2023. This is the result of the corporation's $1 billion equity raising effort for 2019-2023 which has concluded with $1.1 billion in new equity raised by the end of 2023.

In addition to new shareholder capital, usable equity has benefited from a steadily increasing share of retained earnings, which at the end of 2023 accounted for almost 40% of usable equity on a cumulative basis. We expect this trend to be reinforced by AFC's decision to lower the dividend payout ratio to 25% from 30%, starting 2023. Looking forward, we expect AFC's new equity raising initiative over 2024-28 to continue to support the institution's operations.

ASSET PERFORMANCE RESILIENT TO THE CHALLENGING OPERATING ENVIRONMENT

At the end of 2023, over 50% of AFC's development-related assets (DRA) were in countries with sovereign ratings in the Caa-Ca rating categories, indicating a high degree of country risk. Operations in Nigeria, Government of (Caa1 positive) accounted for 34% of DRA, followed by 12% in Egypt, Government of (Caa1 positive), 7% in Senegal, Government of (Ba3 stable), 6% in Cote d'Ivoire, Government of (Ba2 stable) and 5% each in Ghana, Government of (Ca stable) and Gabon, Government of (Caa2 stable). In addition to the weak weighted average borrower rating at Caa1, AFC's asset quality assessment also captures the corporation's comparatively high equity exposures at 15% of DRA and its private sector orientation that could limit the scope for preferred creditor treatment.

However, asset performance has remained resilient in 2023 and in the first half of 2024. The number and amount of nominal non-performing loans (NPL) have remained broadly unchanged in nominal terms compared to one year before. Meanwhile, the share of IFRS Stage 2 assets including loans with 30-90 days payment delays are on a declining trend compared to the entire loan book, taking into account observed trends for the first half of 2024. The corporation's robust asset performance amid a challenging operating environment also reflects the corporation's governance standards and management's early intervention capacity to mitigate materializing risks at an early stage.

In addition to solid provisioning levels that cover almost 190% of NPL, we also take into account targeted credit protections that AFC has put in place which enhance asset credit quality. For instance, in 2023, almost 17.7% of the notional amount of loans benefited from insurance backed by at least A-rated insurance companies, an increase from 16.4% in 2022 and including both single name non-payment insurance (12.1%) and portfolio non-payment insurance (5.6%).

RATIONALE FOR AFFIRMING THE A3 RATINGS

The A3 rating affirmation reflects the corporation's continued adherence to its prudential guidelines to safeguard the corporation's intrinsic financial strength based on solid capital adequacy and high-quality liquidity buffers, commensurate with the corporation's private sector exposures in high country-risk areas. The corporation maintains broad access to diverse liquidity sources, supporting AFC's strong liquidity assessment in line with global peers.

The A3 rating also incorporates AFC's low strength of member support owing to the low average shareholder rating and weak contractual support in the form of very low callable capital coverage of outstanding debt. However, the continued broadening of the shareholder base, including outside of the region, underpins our improved non-contractual support assessment despite the still concentrated shareholding structure among the Central Bank of Nigeria (accounting for 39% of subscribed capital) and Nigerian financial institutions (41%).

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

AFC's credit impact score (CIS-2) reflects its moderate exposure to environmental risk and neutral-to-low exposure to social and governance risks. The assessment reflects the corporation's efforts to diversify towards renewable energy infrastructure projects, thus mitigating carbon transition risk. It also reflects AFC's pro-active adoption of credit protection measures to insulate AFC's asset quality from a deteriorating operating environment.

AFC's environmental risk profile score of E-3 reflects its investments in the hydrocarbon sector, exposing its portfolio to carbon transition risks. This exposure is being mitigated by the corporation's portfolio diversification by sector and its effort to expand investments in the renewable energy sector.

The S-2 social risk issuer profile score reflects AFC's focus on key infrastructure like power generation, port infrastructure, energy generation, and communications infrastructure which expand the population's access to basic services, thereby enhancing AFC's standing in the region.

The governance risk issuer profile score of G-2 reflects sound governance principles and risk management framework. This is evidenced by the corporation's management of commodity price shocks and a deteriorating operating environment, mitigated by the adoption of specific credit protection measures to help insulate the asset quality of its investment portfolio.

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

A significant build-up of the capital buffer via retained earnings and new shareholder capital that materially reduces leverage more in line with the A-rated median would be credit positive, as would the expansion of operations without jeopardizing asset performance through economic and credit cycles. The further diversification of the shareholder base including with the participation of a number of investment-grade shareholders would also be credit positive.

We could downgrade the ratings if asset performance were likely to weaken significantly. An inability to implement the corporation's strategy aimed at strengthening its capital base would also be credit negative. Furthermore, a marked erosion of liquidity buffers or increasing signs that access to funding is weakened significantly would also likely lead to a downgrade.

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.

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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At least one ESG consideration was material to the credit rating action(s) announced and described above. Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1355824 .

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