GCR affirms East African Development Bank's international scale issuer rating of BBB-, balancing operating environment stress with a robust financial profile

Rating Action

Johannesburg, 20 November 2020 – GCR Ratings ("GCR") has affirmed East African Development Bank's international scale long and short-term issuer ratings of BBB- and A3 respectively, with the outlook accorded as Stable. At the same time, the following long and short-term national scale issuer ratings have been affirmed:

Kenyan National Scale ratings at $AAA_{(KE)}$/$A1+_{(KE),}$ with outlook accorded as Stable.
Rwandan National Scale ratings at $AAA_{(RW)}$/$A1+_{(RW),}$ with outlook accorded as Stable.
Tanzanian National Scale ratings at $AAA_{(TZ)}$/$A1+_{(TZ)}$, with outlook accorded as Stable.
Ugandan National Scale ratings at $AAA_{(UG)}$/$A1+_{(UG)}$, with outlook accorded as Stable.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
East African Development Bank	Long term issuer	International	BBB-	Stable Outlook
	Short term issuer	International	A3	

Rating Rationale

The ratings on East African Development Bank ('EADB', 'the bank') balances its geographical risk concentrations, preferred creditor treatment ('PCT'), fairly strong mandate, very strong capitalisation, modest risk position, adequate funding and strong liquidity. The ratings are constrained by the relatively weak overall creditworthiness of its member states, in addition to rising operating environment risks of the African continent, especially in light of the current global pandemic.

The operating environment factors in concentration of developmental exposures to a relatively stronger grouping of East African countries, a less diverse sovereign membership base, and adequately demonstrated track record of preferential treatment, which we think is evidence of the relevance and importance of this institution to its shareholders. However, the balance sheet is exposed to the high and rising operating environment risks of East Africa. We believe these risks continue to rise, reflecting the direct and indirect impact of the COVID-19 pandemic.

EADB is a relatively small regional Multilateral Development Bank ('MDB') established with a mandate to promote socio-economic development and regional integration in East Africa. Its modest size (with developmental exposures of just over US150mln at HY20) is a relative strain to its ability to play a significant countercyclical role and self-fund very large infrastructure or developmental projects. We moderate the mandate and track record assessment for limited growth of the development book. However, we still view the mandate to be broad and stronger in comparison to peers, due to its clearer developmental outcomes reflected by its support for higher risk, earlier stage projects including equity finance for start-ups.

Capital and leverage is a strong positive ratings factor, reflected in the GCR leverage ratio of over 72% as of HY20. We expect the 12-18 months forward looking GCR leverage ratio to remain close to 70% as weak credit conditions in the region continues to limit the bank's appetite for lending. Earnings are good although expected to come under pressure on the back of lower disbursements and the soft interest rate environment. However, we think profit retention is adequate to support the current strong capital position. Loan loss reserve coverage improved significantly to 46% and 63% at FY19 and HY20 respectively, from lows of 22% in FY18, however still lagging rated peers. The loan book is over collateralised at 2.6x but any additional reserving would have an immaterial impact on the capital ratio.

The risk position is a slight positive ratings factor, balancing loan concentrations, relatively high albeit improving NPLs, and very low credit losses in favourable range to that of peers. Impairments were booked significantly lower at 0.1% for FY19 and HY20, down from 1.1% the prior year, reverting to a level observed through the cycle. The highly collateralised loan book supports lower reserving. On the other hand, the bank has historically reported higher NPLs than peers, although the current trend reflects some recovery close to peer range of 3-4%. The reduction in NPLs is attributed to a restructuring exercise by the bank resulting in migration of some borrowers from stage 3 to stage 2 loan classification. Loan concentrations are high, with the top twenty loans accounting for c.92% of total loans at HY20. The impact of COVID-19 on the loan portfolio has been marginal thus far, with most restructured facilities having resumed their repayments from a short relief period. Given the current restrictive lending practices, impairments are expected to remain well below 1% over the next 18-24 months. Market risk is minimal with limited equity investments, and FX lending risks are well managed using natural hedging and PCT when needed.

Our slightly positive view on funding and liquidity balances the less diverse funding sources (although noting improving diversification), strong liquidity levels and high asset concentrations. Funding sources are somewhat concentrated given the relatively low funding needs, however, the bank added new funders to the pool in 2020 and continues to engage prospective funders. Liquidity on the other hand is very strong reflected by a negative net debt position as at HY20. The liquidity coverage ratio was c.4.2x over the same period, although liquid assets are placed with local banks, causing higher asset concentrations.

Outlook Statement

The outlook is stable reflecting our opinion that the bank has capacity to carry out its mandate considering the pandemic, supported by a strong balance sheet. We also factor in the relevance and importance of the bank to its shareholders which we think remains high. Sustained low credit losses, coupled with capital and liquidity managed within adequate to strong levels also supports a stable outlook.

Rating Triggers

The ratings may benefit from a growing development book, more examples of PCT, and reduction in loan concentrations. Reduction in geographical concentrations to weak operating environments would also be viewed positively. The ratings could be lowered if mandate track record diminishes on the back of a sustained reduction of the development book, substantial deterioration in capital, credit losses exceed our expectations, and/or there is an increase in funding and liquidity risks.

Analytical Contacts

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Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Supranational Institutions, May 2019
GCR Ratings Scale, Symbols & Definitions, May 2019
GCR Country Risk Scores, May 2020
GCR Financial Institutions Sector Risk Score, August 2020

Ratings History

East African Development Bank

Rating class	Review	Rating scale	Rating class	Outlook	Date

Long and Short-Term issuer	Initial	International	BB-	Stable	November 2012
	Last	International	BBB-/A3	Stable	December 2019
	Initial	National	$AA_{(UG)}/A1_{(UG)}$	Stable	November 2012
	Last	National	$AAA_{(UG)}/A1+_{(UG)}$	Stable	December 2019
	Initial	National	$AA_{(KE)}/A1_{(KE)}$	Stable	November 2012
	Last	National	$AAA_{(KE)}/A1+_{(KE)}$	Stable	December 2019
	Initial	National	$AA_{(TZ)}/A1_{(TZ)}$	Stable	November 2012
	Last	National	$AAA_{(TZ)}/A1+_{(TZ)}$	Stable	December 2019
	Initial	National	$AA_{(RW)}/A1_{(RW)}$	Stable	November 2012
	Last	National	$AAA_{(RW)}/A1+_{(RW)}$	Stable	December 2019

Risk Score Summary

Rating Components and Factors	Risk score
Operating environment	**12.50**
Country risk score	3.75
Sector risk score	3.25
Membership Strength and Diversity	2.50
Preferential Creditor Treatment	3.00
Business profile	**1.50**
Status and diversity	(1.00)
Mandate and track record	2.50
Management and governance	0.00
Financial profile	**6.00**
Capital and leverage	5.00
Risk	0.50

Funding structure and liquidity	0.50
Comparative profile	**0.00**
Callable capital	0.00
Peer analysis	0.00
Total Score	**20.00**

Glossary

Capital	The sum of money that is invested to generate proceeds.
Cash	Funds that can be readily spent or used to meet current obligations.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings were influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to EADB. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

EADB participated in the rating process via virtual management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from EADB and other reliable third parties to accord the credit ratings included:

- Audited financial results as at 31 December 2019;
- Breakdown of loan book and funding as at June 2020;
- Latest internal and/or external audit report to management;
- Industry comparative data.