



Credit Outlook

4 February 2021

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HCA Healthcare lowers its leverage target, a credit positive

Originally [published](#) on 03 February 2021

On 2 February, [HCA Healthcare, Inc.](#) (Ba1 stable) in its fourth-quarter earnings call lowered its leverage (debt/EBITDA) target to 3.0x-4.0x from 3.5x-4.5x, a credit positive because it indicates the company's willingness to commit to operating with somewhat more conservative financial leverage.

The change suggests management's confidence in its ability to weather the pandemic-related strains on its business and operate with somewhat lower financial leverage over the longer-term than it has in the past. Historically, HCA operated with debt/EBITDA around the mid-4.0x range, but more recently its debt/EBITDA has been maintained below 4.0x, as per the company's definition.

The company's plan to resume share purchases and reinstate its cash dividend in 2021 partly offsets the credit-positive nature of its lower targeted leverage range. HCA's board of directors authorized resumption of its existing share repurchase program, of which \$2.8 billion remained when the program was suspended during the early stages of the pandemic. The board also authorized a new \$6 billion share repurchase program, giving the company \$8.8 billion of total share repurchase capacity. Management noted on the earnings call that it intends to use the majority of its share repurchase authorizations in 2021. Further, the reinstatement of the company's quarterly cash dividend at an 11% higher rate than pre-pandemic will also consume approximately \$600 million of additional cash.

Despite the more muted leverage target, these planned share repurchases far exceed its historical average. Between 2015-20, HCA averaged roughly \$1.7 billion of share repurchases per annum. As of year-end 2020, the company had \$1.8 billion of cash, of which we assume more than half is unencumbered (easily accessible in the US). We forecast about \$2.5 billion of free cash flow after minority interest and dividends in 2021. This implies that, if HCA were to pursue the full amount of authorized share repurchases, it could need to issue up to \$5.3 billion of debt. If this were to occur, we believe that HCA would still remain within its newly stated leverage target of 3.0x-4.0x.

HCA is the largest for-profit acute care hospital operator in the US as measured by revenue. In addition, the company operates psychiatric facilities, a rehabilitation hospital, as well as ambulatory surgery centers and cancer treatment and outpatient rehab centers. Facilities are located in 21 states in the US and in England. HCA, headquartered in Nashville, Tennessee, generated net revenue of approximately \$52 billion over the past 12 months.

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Worthington acquires General Tools & Instruments, divests oil and gas business, a credit positive

Originally [published](#) on 01 February 2021

On 1 February, [Worthington Industries, Inc.](#) (Baa3 stable) announced that it completed the acquisition of General Tools & Instruments for approximately \$115 million in cash and divested its oil and gas equipment business. The transactions are credit positive since the sale of the oil and gas business eliminates a money-losing operation and the acquisition of General Tools will broaden Worthington's consumer products offerings and be accretive to earnings.

The acquisition of General Tools appears to be a good strategic fit since it broadens Worthington's consumer products offerings, which are sold through some of the same distribution channels and will be accretive to earnings and modestly reduce its reliance on joint venture income. Worthington funded the \$115 million acquisition with excess cash from its balance sheet. General Tools & Instruments sells more than 1,200 feature-rich, specialized tools through retailers, industrial distributors and hardware wholesalers. The company generated net revenue of \$68.2 million and adjusted EBITDA of \$15.2 million in 2020.

Worthington had \$713 million of cash as of 30 November 2020, which was bolstered by about \$146.6 million when it sold its remaining 7.05 million shares of Nikola Corporation on 13 January 2021. Worthington provided startup seed capital of approximately \$2 million to Nikola in 2015 and sold all of its 19,048,020 shares for approximately \$634 million. The proceeds from the Nikola investment provide the opportunity for Worthington to continue to pursue strategic investments that reduce its reliance on joint venture income, as well as shareholder friendly actions that may not require debt funding. The company could also retire all of its outstanding debt, but the company has no material debt maturities until August 2024 and has not indicated any plans to use this cash for debt reduction.

Worthington also announced the sale of its money-losing oil & gas equipment business including its Westerman, Inc. subsidiary and the related operating assets located in Bremen, Ohio, and Tulsa, Oklahoma, for nominal consideration with the opportunity for additional consideration in the future. This business was built through acquisitions and demonstrates the risks and inconsistent results of the company's long term acquisition program that also included its money-losing engineered cabs business that was divested last fiscal year. The sale of this business is credit positive since it will eliminate its losses and should provide a tax benefit since the company will record a one-time pretax loss estimated to be in the range of \$25-\$30 million.

We anticipate that Worthington will produce materially stronger adjusted EBITDA in fiscal 2021 (ending May 2021) versus the \$337 million of adjusted EBITDA in fiscal 2020. The significantly improved operating performance will be driven by higher volume and improved productivity versus the COVID-19 affected period last year, as well as improved metal spreads and steel inventory holding gains in its steel processing segment. Worthington should continue to generate free cash flow despite increased investment in working capital, which has been enhanced by the Nikola share sales and could produce credit metrics that are strong for its rating, including a leverage ratio (debt/EBITDA) below our upgrade guidance of less than 2.0x. However, its ratings upside will remain limited by its moderate scale and reliance on joint venture income, which contributed about 50% of its total adjusted EBIT in fiscal 2020. Nevertheless, a ratings upgrade could be considered if the company uses its healthy cash balance to retire debt or materially reduces its reliance on joint venture income.

Worthington Industries, Inc. is a diversified metals manufacturing company that performs steel processing, produces pressure cylinders, steel tanks and specialized tools. The company is headquartered in Columbus, Ohio and serves customers in the automotive, construction, industrial, consumer products, agriculture, heavy truck and alternative fuels sectors. Worthington operates 23 wholly-owned facilities worldwide and holds equity positions in nine joint ventures that operate 47 additional facilities. Worthington's business segments include steel processing (63% of year-to-date fiscal 2021 sales) and pressure cylinders (37%). Worthington generated revenues of about \$2.8 billion for the 12 months that ended 30 November 2020.

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US and Canadian travel restrictions delay tourism recovery in Mexico and the Caribbean

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The government of Canada on 29 January announced additional measures to contain the COVID-19 pandemic, including an agreement with local airlines to suspend flights to Mexico and the Caribbean until 30 April. The new Canadian measure comes shortly after a new [US requirement that passengers from abroad receive a negative COVID-19 test before entering the US](#).

The measures are credit negative for airports that facilitate travel between North America and Mexico, and the rest of the Caribbean, as well as for lodging companies operating in the region, which had previously largely been free of travel restrictions. Mobile providers in the Caribbean that depend on tourism and prepaid customers will struggle with the new restrictions as well.

The new restrictions are unwelcome news for [Playa Resorts Holding B.V.](#) (Caa1 negative), the operator of all-inclusive resorts in beachfront locations in Mexico, Dominican Republic and Jamaica, which by November had re-opened 18 of its 21 resorts. Playa initially closed all of its properties at the outset of the pandemic, and began gradually reopening its properties in July 2020. A halt in the recovery would be particularly stressful for [Grupo Posadas, S.A.B. de C.V.](#) (Ca negative), the leading hotel operator in Mexico, given its weak liquidity that led to a missed interest coupon payment in June 2020.

Mexico is among the world's top 10 destinations for international tourists, according to the UN World Tourism Organization (UNWTO). Around 70% of the international passengers come from the US and Canada. Aside from the airports serving Mexico City and Guadalajara, most arrive at airports in coastal destinations. Cancun on the Caribbean coast accounts for 32.5% of travelers from overseas, followed by San Jose del Cabo (8.2%) and Puerto Vallarta (7.5%), both in the Pacific Coast.

A lack of travel restrictions boosted a recovery in Mexico's tourism at the end of 2020 after a sustained improvement since April 2020. As of November 2020, the UNWTO reported only a 52% annual decline in international arrivals to Mexico, well below the 74% global decline in arrivals, and better than any of the other top 10 destinations, such as Italy, with arrivals down by 63%, and China, down by 89%. By December the annual decline in Mexico was 46%. The Cancun hotels association reported nearly 50% average occupancy for the month, approaching 60% during Christmas holidays.

The Secretaría de Turismo (SECTUR), Mexico's tourism ministry, estimates that the restrictions set by the Canadian government will reduce tourism in 791,000 people, 77% less than in 2020. While Mexican airlines can offset some of this decline, Canadian travelers will likely seek to avoid the pending requirement that they take a COVID-19 test upon landing in Canada—a measure that also requires all passengers to await results in government-approved hotels and cover their own costs. SECTUR estimates that a 72 hour stay would cost up to CAD2,000 (USD1,562). Passengers who test positive must then quarantine at government facilities.

Both the US and Canada require that passengers test negative for COVID-19 within three days of departure. To ease travelers' concerns about how to get tested, some Mexican hotels have recently added testing sites. But the hotels will have no control over the Canadian requirement for testing upon arrival, discouraging travelers.

In the rest of the Caribbean, the measures will stifle a recovery in tourism during the peak season, which generally runs from the end of the fourth quarter to the end of the second quarter, when the hurricane season starts. The overall region has a higher exposure to US travel than Mexico and will therefore be more affected. Foreign travelers represented 73% of total traffic in 2020 for the San Juan Santa Maria airport in Costa Rica ([Aeris Holding Costa Rica S.A.](#), B3 negative). More than 90% of travel through the six Dominican airports run by [Aeropuertos Dominicanos Siglo XXI, S.A.](#) (B1 negative) is international, mainly from the US.

Meanwhile, the new measures will especially hurt mobile providers in the Caribbean, which generate high concentrations of revenue from the prepaid segment, and which depend on tourism within markets already experiencing severe mobility restrictions, including Jamaica, and the Dominican Republic. The rated telecom operators in the Caribbean have also faced problems with collections, leading to customer disconnections and an increase in provisions for bad debt.

EBITDA margins for the region's telecom operators continue to improve on the back of efficiencies, cost cutting, significant shifts in data usage, and strength in the broadband segment. But companies including [Liberty Communications PR Holding LP](#) (B1 stable) and [Telecommunications Services of Trinidad](#) (B2 stable) will not meet their deleveraging plans, although both companies have well-invested infrastructure, giving them more flexibility to reduce capital spending and generate positive free cash flow. Liberty PR also has a fully available \$150 million committed facility in case of need.

[Cable & Wireless Communications Limited](#) (Ba3 negative) and [Digicel Group Holdings Limited](#) (Caa2 stable) operate in undiversified economies that depend on tourism or commodities highly exposed to foreign-exchange volatility, and to adverse weather events. Yet while both companies are highly levered, we expect that they will generate neutral to positive free cash flow through at least 2021. Both companies have adequate liquidity, with no large maturities until at least 2023.

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Brenntag's acquisition of Zhongbai Xingye is credit positive

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On 28 January, [Brenntag AG](#) (Baa3 positive) announced that it signed an agreement to acquire the majority of Chinese specialty food ingredients distributor Zhongbai Xingye Food Technology (Beijing) Co., Ltd., starting with a 67% stake valued at an enterprise value of about €90 million. The acquisition is credit positive and will strengthen Brenntag's business profile.

We generally view acquisitions in the fields of specialty food ingredients as positive from the business profile perspective. The underlying demand in this market tends to be fairly resilient to economic cycles and even in 2020 it showed robust growth. Specialty food ingredients distribution tends to be more profitable than commodity distribution as well as specialty distribution for industrial end markets because it offers more opportunities to provide higher value added services to help the customers cope with the increasingly complex and costly regulations in the food markets. In specialty food ingredients distribution products and services are sometimes co-developed with the customers, which further increases the customers' costs of switching to other suppliers.

A stronger position in China and Asia-Pacific (APAC) in general is also positive for growth as APAC markets have above-average growth potential. While Brenntag currently generates only roughly 10% of its revenue in APAC, it estimates it is already the second-largest distributor in the region.

Brenntag follows a strategy to complement the organic growth with a flow of small to medium acquisitions, operating in a market that despite an ongoing consolidation remains highly fragmented. The company has been an important consolidator in the sector since the 1990s, having completed around 100 deals since 2007 with an average size of around €20 million. This acquisition strategy has enabled Brenntag to enhance its scale, geographical diversification and product portfolio in a controlled way with very limited integration risk. On average, between 2007 and 2019, Brenntag generated Moody's-adjusted free cash flow (FCF) of around €160 million and spent around €150 million on acquisitions, both on an annual basis. Brenntag guides its annual acquisition budget to be in the range of €200 million-€250 million per annum, which we expect to be broadly covered by its FCF generation in 2021.

The 100% acquisition of the entire share capital of Zhongbai Xingye will be executed in two steps. The first tranche comprises a majority stake of 67%. The remaining 33% will be acquired by Brenntag by end of 2024. The acquired business generated sales of approximately €146 million for 12 months to June 2020. Closing of the first tranche is subject to regulatory approvals and is expected to be completed in the first half of 2021. Closing of the second tranche is expected at the end of 2024.

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Gajah Tunggal's consent solicitation to support its refinancing plans is credit positive

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On 1 February, [Gajah Tunggal Tbk \(P.T.\)](#) (GJTL, Caa1 negative), an Indonesian tyre maker, announced a consent solicitation related to its \$250 million senior secured bond due in August 2022. The company is seeking bondholder consent to amend terms related to limitations on incurring indebtedness and permitted liens. The terms, if amended as proposed, will allow the company to incur up to IDR1.4 trillion (\$99 million) under a secured term loan (new loan) that will be used to refinance its existing senior secured term loan due in July 2022 in full. The consent solicitation is a proactive step taken by the company to address its upcoming debt maturities and reduce refinancing risk, a credit positive.

If the transaction is completed as planned, GJTL's next major debt maturity will be its \$250 million senior secured bond due in August 2022. The company also had IDR631 billion of short-term working capital loans outstanding as of 30 September 2020, which historically it has rolled over.

According to GJTL's bond indenture, the company can incur indebtedness if it is used for refinancing. However, GJTL needs to seek consent because the company intends to secure its new loan under a collateral package separate from its 2022 bond. Currently, GJTL's existing senior secured term loan and its 2022 bond are secured largely by the same assets, facilities, land and equipment on a *pari passu* basis. The consent solicitation expires on 17 February 2021, and requires a simple majority of the bondholders.

Legal subordination risk on the bond is limited because the bond continues to constitute the majority of the debt in GJTL's capital structure. In addition, its new loan will amortize over time. GJTL is required, under its bond indenture, to maintain collateral value of at least 150% over its outstanding bond amount.

We expect that interest costs will increase as the company refinances US dollar debt with more expensive rupiah borrowings. However, debt-service coverage is likely to improve overall because we expect amortization payments under its new loan to be more manageable. Also, refinancing the US dollar debt with rupiah borrowings reduces some of GJTL's exposure to foreign-exchange risk. While the company earns 60% of its revenue in rupiah, most of its raw material costs and debt obligations are denominated in or linked to the US dollar.

GJTL's Caa1 rating reflects the company's weak liquidity as a result of its reliance on short-term funding and the small buffer under its existing term loan maintenance covenants. The rating also considers the volatility in GJTL's margins and cash flow, driven by rupiah and raw material price movements. The negative outlook on GJTL's ratings reflects the refinancing risks associated with GJTL's short-term working capital loans as well as significant debt maturities in 2022.

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Wijaya Karya repays Komodo bond, alleviating refinancing risk

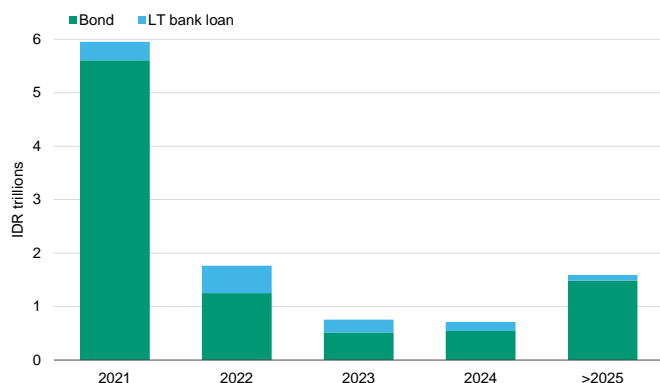
Originally [published](#) on 03 February 2021

On 29 January, Indonesian construction company [Wijaya Karya \(Persero\) Tbk. \(P.T.\)](#) (WIKA, Ba3 negative) repaid its IDR5.4 trillion (\$385 million) Komodo bond at maturity. The Komodo bond was refinanced with an IDR1.5 trillion mix of Indonesian rupiah bonds issued in December 2020, and IDR3.0 trillion of loans from three state-owned banks. The company repaid the remaining IDR900 billion from existing cash balances.

The timely repayment of the Komodo bond alleviates WIKA's refinancing pressures and extends its debt maturity profile. However, while the Indonesian rupiah bonds have a maturity of three to seven years, the bridge facilities from banks are due between November 2021 and December 2022. Nonetheless, following the repayment of WIKA's Komodo bond, the company has a well-laddered debt-maturity profile, as shown in Exhibits 1 and 2.

Exhibit 1

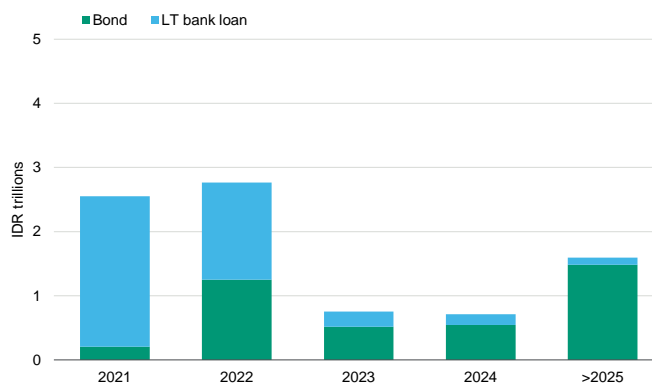
WIKA's debt amortization pre-refinancing



Source: Company information

Exhibit 2

WIKA's debt amortization post-refinancing



Source: Company information

WIKA plans to refinance the bridge loans through issuance in the Indonesian rupiah bond market during 2021 under its domestic currency notes program. In addition, WIKA has IDR15.4 trillion in short-term bank facilities, which the company rolls over annually. WIKA's track record of issuance and its status as one of the largest state-owned construction companies bode well for its access to the bond and bank markets for future refinancing.

WIKA's construction business has been severely affected by the protracted coronavirus pandemic. We expect Indonesia's pandemic-related supply-chain disruptions and restrictions on construction work to delay the completion of all of WIKA's projects. Consequently, we expect its leverage, as measured by adjusted debt/EBITDA, to peak at about 13.0x in 2020 and remain at 7.8x-9.0x through 2022, assuming no government equity support is received.

In September 2020, the Ministry of State-Owned Enterprises announced it plans to reorganize state-owned hotels and consolidate them under a holding company, SOE Hotel Holding. WIKA's property and realty subsidiary, WIKA Realty, was appointed the parent company of SOE Hotel Holding.

SOE Holding Hotel will be established in 2021 and the assets of its members will be consolidated at WIKA Realty. This, in conjunction with WIKA's plans to list WIKA Realty, will provide an opportunity to monetize investments to deleverage the balance sheet to some extent. However, details of the transaction are still unclear.

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Brazilian fintech Nubank raises \$400 million to maintain fast growth, a credit positive

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On 28 January, Brazilian online bank Nu Pagamentos S.A. (Nubank) raised \$400 million of fresh capital, attracting new foreign private-equity investors to its fast-growing Latin American platform. The capitalization is credit positive because it will support the company's expansion into complementary banking services beyond its traditional low-cost credit-card business. It will also allow Nubank to bolster its capital and support the growth of its recently opened subsidiaries in Mexico, Argentina and Colombia.

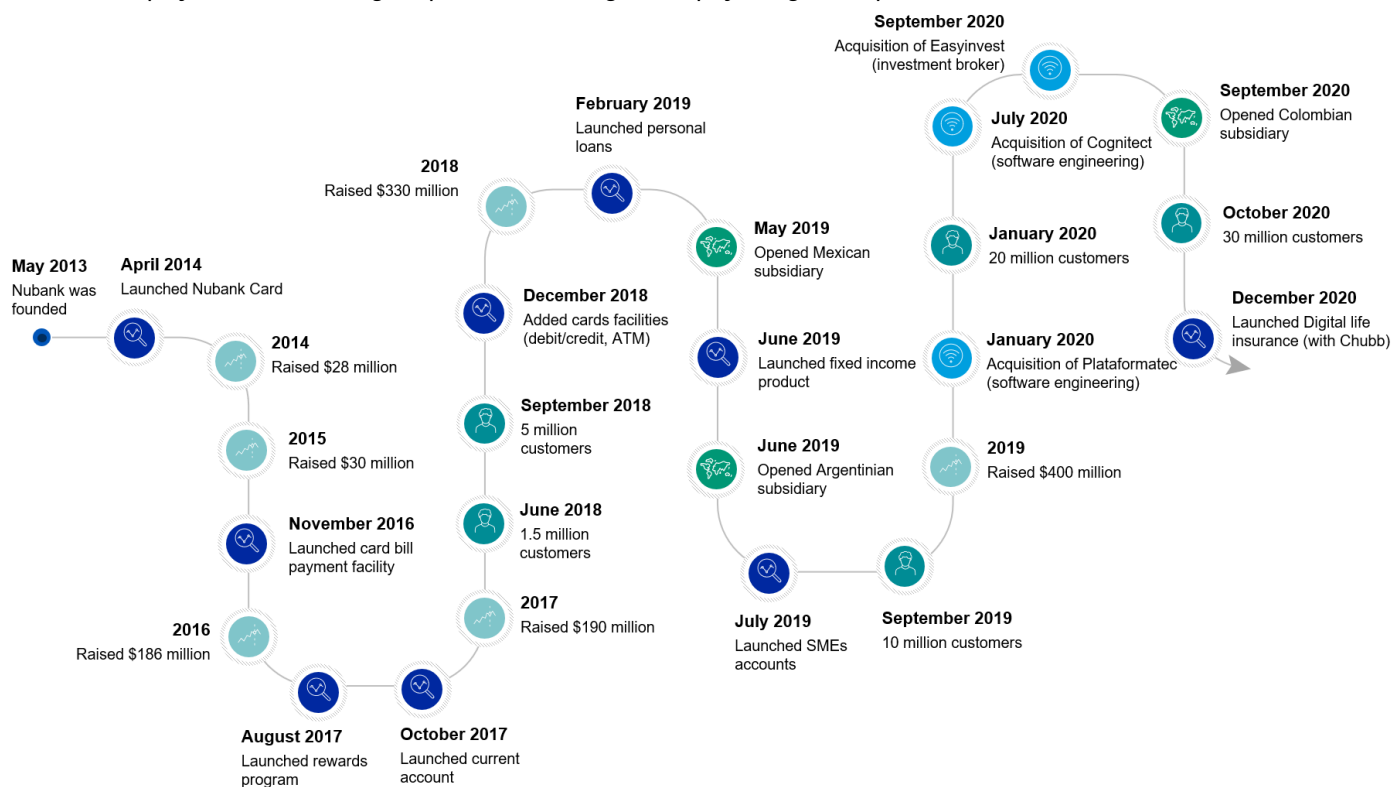
The company estimates that the capital injection will provide enough cash to sustain the growth of its Brazilian operation over the next two to three years. It also foresees a potential new issuance in the local markets to support business volume growth. In addition, Nubank plans to accelerate investments in its Mexican unit opened in May 2019, in Argentina (June 2019) and in Colombia (September 2020), all of which are still in their infancy.

Building on its offering of fee-free credit cards and a user-friendly digital interface, Nubank plans to develop into a full-service bank by leveraging the acceleration in digital banking in 2020, when it opened almost 41,000 accounts per day. The number of customers with a Nubank digital account (Nuconta) jumped to 34 million at the end of 2020 from 12 million in 2019. Approximately 20% of its customers were previously unbanked, according to management. In Brazil's competitive credit-card segment, as of September 2020, Nubank had a 4.2% share of the credit-card outstanding amounts, compared with [Itaú Unibanco Holding S.A.](#) (Ba3 stable), the segment leader, with a 30.4% market share.

The company has grown rapidly since its founding in 2013. Using the information generated by its card receivables, it began to diversify its operations from 2017 by offering cash management services, short-term loans and current accounts to small and midsize companies. In 2020, it boosted its online business platform through the acquisition of software providers Plataformatec and Cognitect, and investment broker Easyinvest (see exhibit).

Nubank's rapid expansion raised the need for further capitalization

Timeline of company milestones, including new products, customer growth, equity raisings and acquisitions



Sources: Nubank, AlphaSense and Moody's Investors Service

Nubank's growth has been supported by venture capital as well as by domestic debt and asset-backed securities issuances since its inception. It has raised a total of \$1.2 billion in equity, primarily from global technology investors including Sequoia Capital, DST Global, Founders Fund, Ribbit Capital and QED Investors. [The Goldman Sachs Group Inc.](#) (A2 stable) and Fortress Investment Group LLC have also supported Nubank's expansion through credit facilities in place since 2016. In 2018, one of the world's largest global technology firms, China's [Tencent Holdings Limited](#) (A1 stable), acquired a 5% stake for \$180 million.

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BNDES plans repayment to National Treasury, a credit positive that reflects its evolving role

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On 28 January, [Banco Nacional de Desenvolvimento Econômico e Social](#) (BNDES, Ba2 stable, ba2¹) announced it will repay BRL38 billion owed to the National Treasury of Brazil in this quarter, a credit positive.

The repayment reflects BNDES' strategy of balance sheet discipline and its goal of becoming a partner in infrastructure financing. In the past, BNDES' role was providing aggressive countercyclical support for the government's agenda and being a sole provider of long-term financing for large companies and infrastructure projects, which uses more balance sheet resources than partnering.

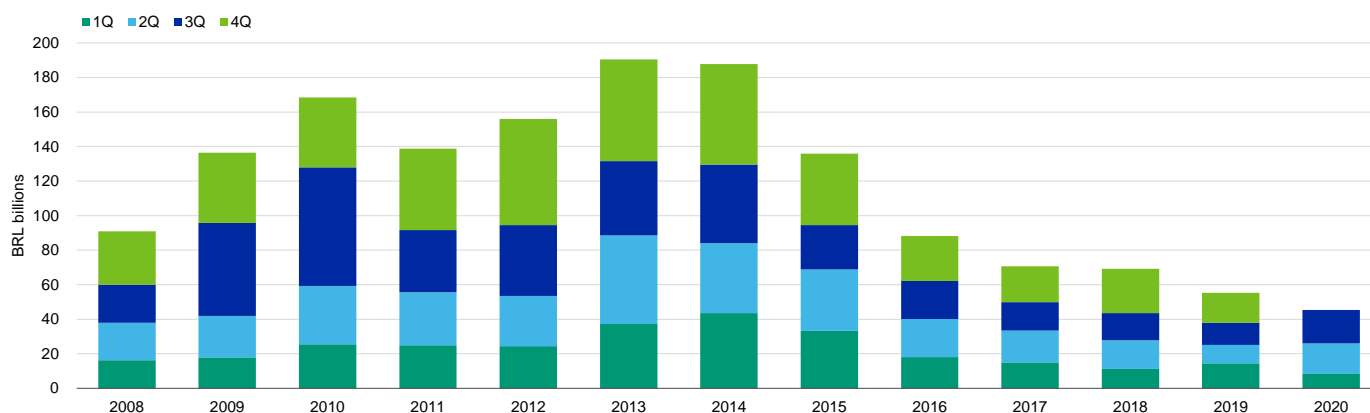
BNDES received a total of BRL440 billion from the treasury in 2008-14, and has already repaid BRL531 billion in principal and interests. The bank is preparing a repayment schedule for the remaining BRL160 billion, in addition to hybrid capital instruments also owed to the treasury.

In 2020, BNDES' role combating the coronavirus outbreak was quite different from the support it provided during the 2008 global financial crisis. The bank focused on small and mid-sized enterprises (SMEs) rather than on subsidized loans to large corporations as in 2008. Also, more than a half of BNDES' pandemic-related measures were through guarantees from the National Treasury to facilitate credit for SMEs or partnerships with other players, which implied modest direct financing support. This was the case for BNDES' partnership with other banks to tailor financial help to specific sectors through syndicated loans or capital market operations.

In the first nine months of 2020, BNDES' loan portfolio decreased 1.5% to BRL469.6 billion (Exhibit 1), despite new loans increasing 19% to BRL45.3 billion in the period. This volume of new loans is less than a half of the average loan concessions from 2008-15, with a peak of BRL132 billion new loans originated in September 2013.

Exhibit 1

BNDES' 2020 loan originations through the third quarter recovered during the pandemic Amounts in BRL billions



Sources: BNDES and Moody's Investors Service

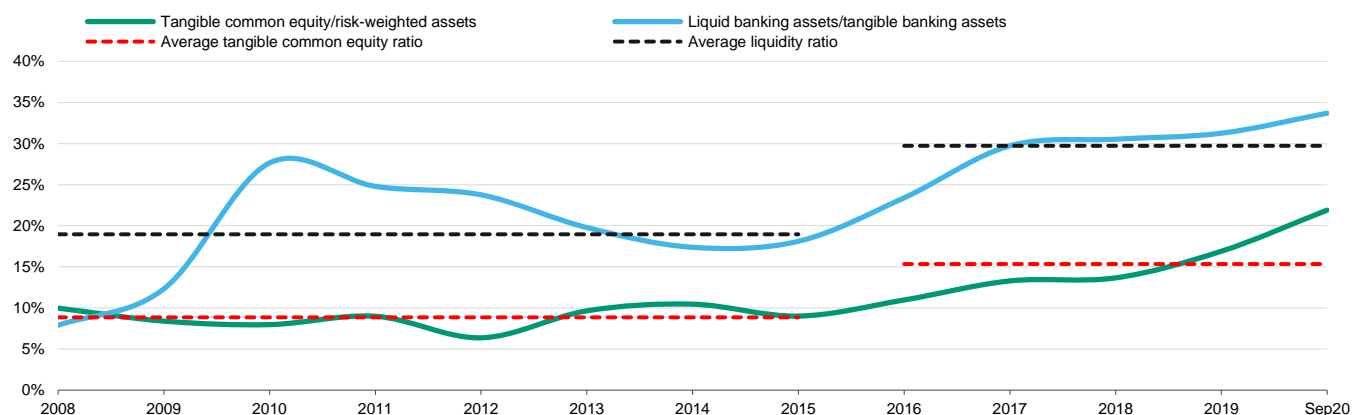
BNDES' enhanced balance sheet discipline has allowed it to pursue projects in capital markets and play an advisory role in structuring projects on behalf of the federal government for its pipeline of privatizations and private enterprise concessions for public services. Additionally, the bank plans to provide guarantees to infrastructure project as a way to foster investments in the sector. The guarantees will be contingent liabilities instead of loans, and will broaden the bank's business scope beyond that of a traditional lender.

Repaying funds to the Treasury will not change BNDES' strong liquidity and capital positions, which were reinforced in the past years by a combination of modest demand for new loans, divestments of equity holdings, strong one-off results and earnings reinvestments.

Since mid-2015, BNDES revised and capped the amount of annual dividends upstreamed to the government. Consequently, its tangible common equity (TCE) to risk-weighted assets (RWA) ratio² improved to a 13.7% average 2016-19, peaking at 22% in September 2020, from a 8.9% average between 2008-15. Even excluding the BRL35.5 billion capital instrument from the treasury in form of federal bonds, we estimate the bank's TCE to RWA would still be comfortable at 14.4% (Exhibit 2).

Exhibit 2

BNDES' repayment of funds to treasury will not impair its capital and liquidity strength of the past five years



Sources: BNDES and Moody's Investors Service

The bank's strong liquidity position, further reinforced by equity sales, should not be compromised by the repayments to the treasury, because BNDES can only use resources raised through inflows from loans to repay the funds. Liquid banking assets averaged 29% of tangible banking assets in the past five years, which is 10 percentage points higher than the 2008-15 average.

Endnotes

¹ The BNDES ratings in this report are its long-term local currency deposit rating and Baseline Credit Assessment.

² Our calculation of tangible common equity adjusts Brazilian federal government bonds with a 100% risk weighting factor in line with Brazil's Ba2 sovereign rating. The regulatory risk weight for those assets is zero ratio.

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France's revised guidance to reduce banks' housing loan risk is credit positive

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On 28 January, France's Haut Conseil de Stabilité Financière (High Council for Financial Stability, or HCSF), the country's macro-prudential authority, released new [guidance on minimum credit standards for banks' housing loans](#). This guidance, which will be legally binding next summer, is credit positive for both French banks and structured finance transactions (covered bonds and residential mortgage-backed securities) because it will mitigate the risk of loan delinquency or default on rising household debt.

The new measures are slightly less stringent than those enacted in December 2019, yet still will contribute to reducing banks' risks from the housing sector. The HSCF's recommendations seek to curb the number of loans with monthly installments exceeding 35% of households' monthly income (defined as debt-service-to-income [DSTI] ratios of more than 35%) or with a maturity at origination of more than 25 years, or both.

Aided by ultra-low interest rates, France's housing loans have been growing at a pace of 4%-6% a year since 2015 as competition between lenders pushed banks to offer lower rates and loosen underwriting standards. In December 2019, the HSCF issued [a first set of recommendations to curb housing loan risks](#).

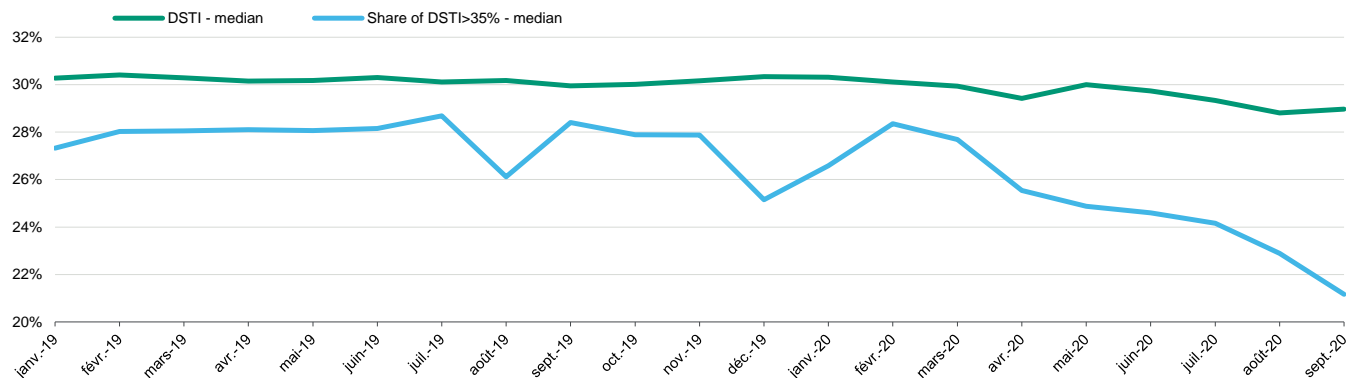
Under the revised guidance, the threshold for the maximum DSTI moved to 35% from 33%. The maximum loan maturity set at 25 years can be extended by up to two years in case of a lag between the granting of the loan and the moment the borrower takes possession of the property, typically in the case of new construction or substantial renovation.

The revised guidance also specifies how banks should estimate DSTI to ensure similar calculations between lenders. For example, the calculation must incorporate monthly home loan insurance payments, which was not the case previously. Most housing loans are repaid by monthly installments, which makes the DSTI a key default indicator: borrowers with high DSTI ratios are more likely to default on their debt obligations than borrowers with lower ratios. Even if the new measures are slightly looser than the previous ones, the framework is still positive for the default frequency of newly originated loans because it puts a lid on households' indebtedness.

Under the revised guidance, the HCSF also increased to 20% from 15% a bank's new production of housing loans that can deviate from the aforementioned rules. At least 80% of the loans benefitting from this flexibility must be granted for the purchase of the main residence and no more than 30% extended to first-time buyers. Gone is the previous rule stating that the borrower's indebtedness should not exceed seven times annual revenue.

The HCSF's decided to slightly relax the rules despite continued strong growth in French housing loans (5.9% annualized in 2020), on the grounds that banks applied underwriting criteria in a stricter manner in 2020. For example, DSTI ratios as well as loan maturities have started declining after having sharply increased since 2015.

French banks' DSTI ratio started to decrease in 2020



Source: Autorité de Contrôle Prudentiel et de Résolution

The revised guidance also underpins the HCSF's aim of supporting the economy during the coronavirus-related crisis by maintaining households', and particularly first-time buyers', access to property and facilitating the purchase of new construction homes.

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Russia's central bank forecasts low portion of restructured loans will become problematic, a credit positive for banks

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On 28 January, the Central Bank of Russia (CBR) said that it expected only 20%-30% of bank loans restructured as a result of the pandemic to become problematic, requiring incremental credit loss charges of around 2% of banks' loan book this year. Such an outcome would be credit positive for Russian banks because pressure on profitability stemming from credit losses will begin to ease. The CBR's moderate credit loss projections are also credit positive for banks in light of the regulator's declared readiness to phase out regulatory forbearance measures introduced in connection with the pandemic.

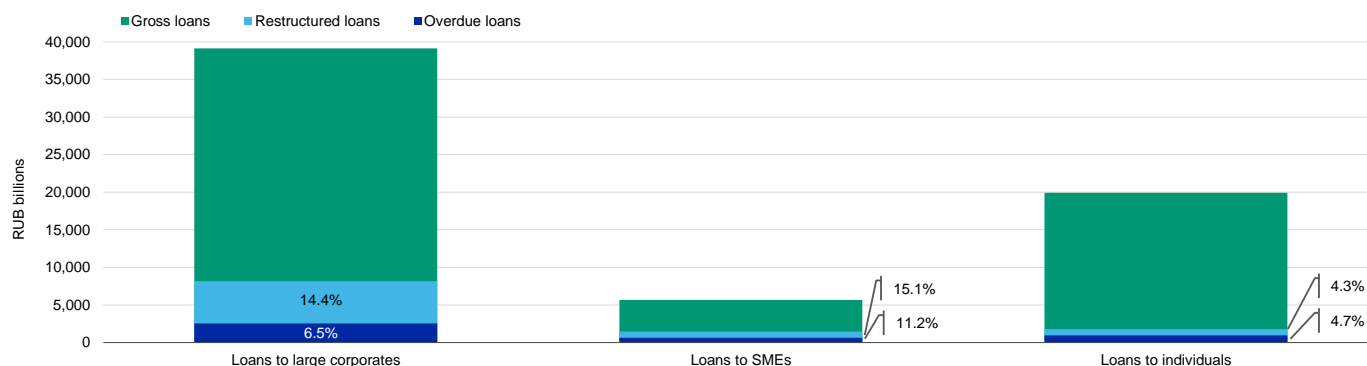
We estimated at the start of the pandemic that incremental problem loans because of the coronavirus crisis would result in credit losses of around 5.6% of Russian banks' loan portfolio, spread over 2020-21. However, the CBR allowed banks to postpone classifying loans restructured during the pandemic as problem loans, and to delay the accrual of loan loss reserves on such loans. In August 2020, it [extended](#) the time span for these forbearance provisions to 1 April 2021 for loans to large corporates and to 1 July 2021 for loans to small and midsize enterprises (SMEs) and individuals, having previously set a deadline for all loan classes of 30 September 2020.

Ten percent of banks' loans had been restructured as of the end of 2020, according to the CBR, including 14% of total loans to large corporates, 15% of loans to SMEs and 4% of loans to individuals (see Exhibit 1).

Exhibit 1

Restructurings have allowed banks to avoid a sharp increase in loan delinquencies

Russian banks' overdue and restructured loans as % of total loans, by loan segments, as of year-end 2020



Overdue loans refer to loans overdue by more than 90 days.

Source: Central Bank of Russia

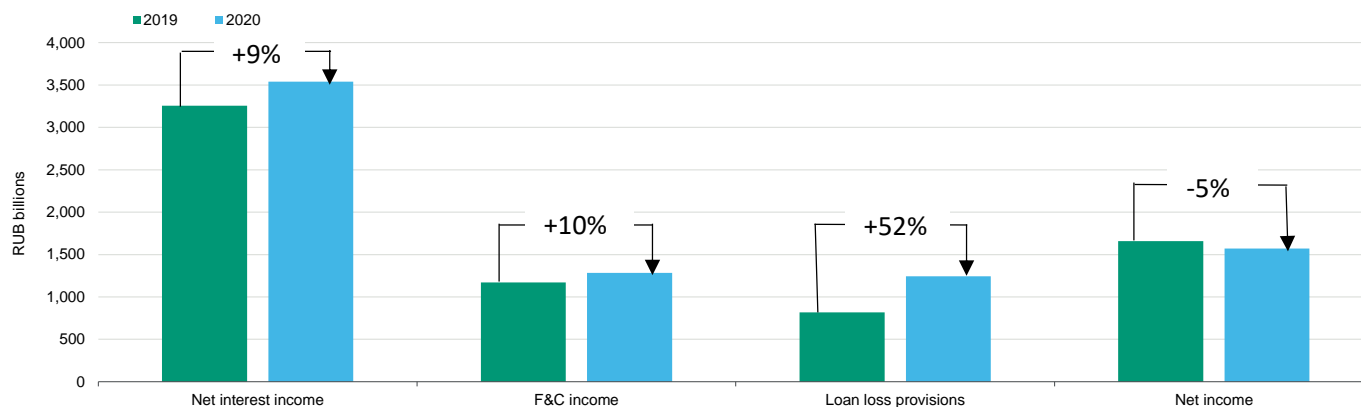
This intensive loan restructuring, coupled with regulatory forbearance measures, allowed banks to charge relatively moderate provisions in 2020 under local accounting rules. Based on CBR data, we estimate that the sector's credit losses accounted for 2.4% of average gross loans in 2020.

With the CBR set to phase out its forbearance measures this year, we estimate that banks' profits will be sufficient to compensate for the level of credit losses the regulator has forecast. Overall, banking sector net profit of RUB1.6 trillion for 2020 could absorb credit losses equivalent to 3% of the sector's average gross loans.

Russian banks' net interest income rose by 9% in 2020 compared with 2019 (see Exhibit 2), according to the CBR, driven by rapid loan book growth. Corporate loans rose by 9% and loans to SMEs by 20%, while mortgages grew by 25% and unsecured consumer loans by 9%. Banks' fee and commission (F&C) income rose by 10% over 2019 because of a lockdown-induced increase in the volume of noncash banking transactions.

Exhibit 2

Banks' increased revenues have partially compensated for the step-up in loan loss provisions 2020 vs 2019



Source: Central Bank of Russia

The sector also accumulated an aggregate capital cushion in excess of the minimum levels of capital requirements and capital buffers prescribed by Basel III, and could additionally absorb credit losses of around 5% of sector average gross loans before reaching the capital buffers, reflecting its solid safety margin in the face of upcoming credit losses.

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Bulgarian regulator extends measure requiring banks to capitalise 2020 profits, a credit positive

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On 28 January, the Governing Council of the Bulgarian National Bank (BNB), the central bank, asked banks to fully capitalise their 2020 profits, extending the measure adopted in March 2020 that required Bulgarian banks to capitalise their 2019 profits. The move is credit positive because it will enhance banks' loss-absorption capacity and solvency amid the higher credit risk related to the economic fallout from the coronavirus pandemic. It will also bolster banks' ability to provide credit to the real economy, supporting a potential recovery.

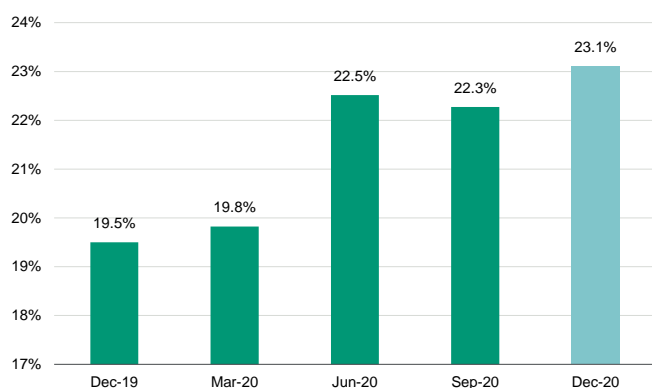
BNB's stance is stricter than that of some other European regulators, [which have allowed banks to pay limited dividends](#) from their 2019 and 2020 profits. However, most Bulgarian banks do not have to directly engage with public shareholders and, therefore, contend with the prospect of increased cost of equity by not paying dividends because they are subsidiaries of large European banking groups. These subsidiaries accounted for 71% of the sector's assets as of September 2020 and include the country's four largest banks.

Bulgarian banks hold significant capital buffers to absorb unexpected losses and the measure will further help them absorb a deterioration in asset quality as coronavirus-induced restrictions on people's movements and the economic slowdown affects the finances of both businesses and households. We [expect a sharp rise in European banks' loan losses](#), with loans to small and midsize enterprises and unsecured consumer lending most at risk.

Based on preliminary information, Bulgarian banks will capitalise profits equivalent to BGN789 million (around €400 million) for 2020, which will raise the sector's aggregate Tier 1 capital ratio by 1.23 percentage points to a pro forma 23.1% at the end of 2020. The sector-wide Tier 1 capital ratio improved to 22.3% in September 2020 from 19.5% at the end of 2019, and its leverage ratio was 12.2% as of September 2020, both of which compare well with regional peers (see Exhibits 1 and 2).

Exhibit 1

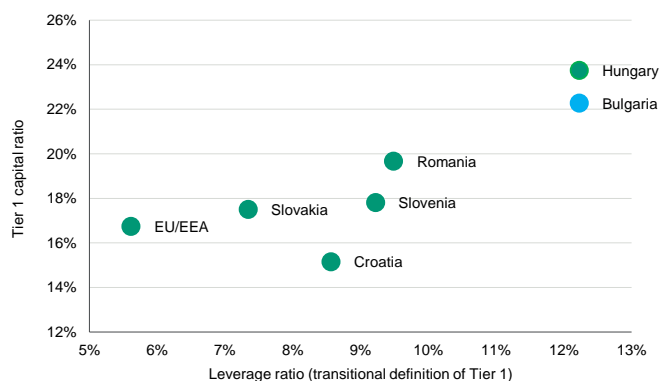
Bulgarian banks' capitalisation will continue to improve in 2020 Tier 1 capital ratio evolution



The December ratio is based on pro forma figures provided by BNB.
Source: Bulgarian National Bank

Exhibit 2

Bulgarian banks' capital metrics compare favourably with peers Tier 1 capital ratio and leverage ratio peer comparison as of September 2020



Sources: Bulgarian National Bank and European Banking Authority

Regulatory capitalisation improved in 2020 because of earnings retention as well as changes to the calculation of regulatory capital following the European Union's (EU) Capital Requirements Regulation (CRR) "quick fix" in June 2020 in response to the coronavirus pandemic. The CRR quick fix reintroduced transitional arrangements on the treatment of exposures to central governments and central banks of EU member states in a currency other than the domestic currency,¹ and benefited Bulgarian banks' capital metrics by reducing risk-weighted exposures. Unlike capital retention, the CRR changes, which were a major contributor to reducing risk exposures by

8.9% in the second quarter of 2020, [do not benefit banks' loss-absorption buffers](#) but do provide additional headroom against their minimum capital requirements.

The coronavirus-induced economic downturn will drive up nonperforming loans (NPLs) following a steady decline in recent years and delay banks' efforts in addressing legacy problem loan issues. NPLs were 7.2% of Bulgarian banks' gross loans at the end of September 2020, in line with the end of 2019, according to European Banking Authority (EBA) data, but were higher than the EU average of 2.8%. Provision expenses, meanwhile, almost doubled in 2020 compared with 2019, halving the sector's profit. The effect of the coronavirus shock on loan quality during 2020 has been deferred by government support measures and payment holidays on loans.

Banks in Bulgaria had approved payment deferrals on 15% of corporate loans and 7% of household loans as of the end of 2020. Borrowers could apply for a payment deferral until the end of September 2020 with the last deferrals potentially ending by 31 March 2021. However, in December the BNB approved an extension that allows applications for deferrals until March 2021 and deferrals until the end of 2021, but for not more than nine months in total, in line with EBA guidelines.

We expect loan quality to deteriorate in the coming quarters as loan payment deferrals expire and the authorities gradually end economic support measures.

Endnotes

- ¹ The new regulation also included additional transitional arrangements for IFRS 9 accounting and lower risk weights assigned to small business and infrastructure exposures.

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Bangladesh lifts loan moratorium but allows extended payment terms, a credit positive for banks

On 31 January, the Bangladesh central bank announced that it will not extend the loan repayment moratorium that was introduced after the start of the coronavirus outbreak. Instead, the central bank will allow banks to extend the repayment period for term loan installments. This scheme will only be available to unclassified term loans.

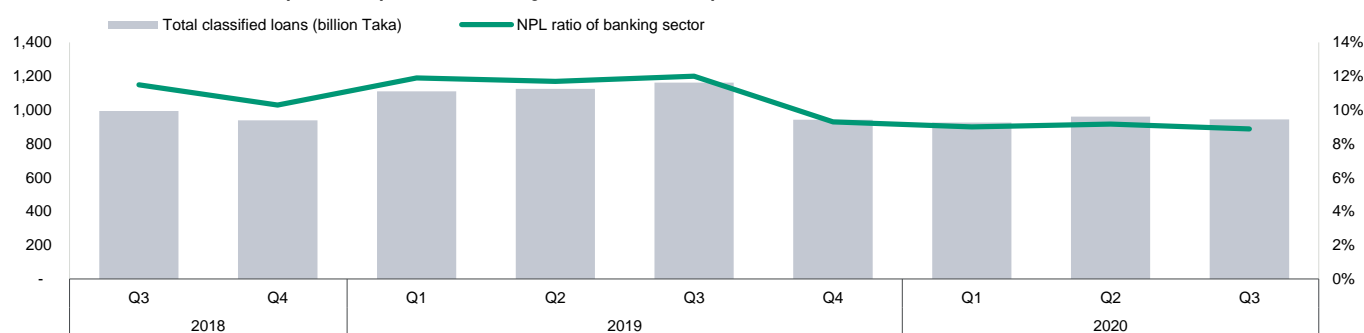
The extension of loan tenure – a type of loan rescheduling – is credit positive because it will reduce the risk of a sudden surge in nonperforming loan (NPL) ratios. With the expiry of the moratorium, borrowers face higher monthly installments because the maturities remain the same, resulting in amortization of loan balances over a shorter period. The loan tenure extension will alleviate pressure on borrowers because they will have up to an additional two years to make repayments.

The moratorium's end is also credit positive because it restores transparency and payment discipline in the banking system, ensuring the comparability of asset quality between banks within Bangladesh. It will allow banks to identify those borrowers that are truly affected by the economic slowdown and those that are willful defaulters. In addition, revealing the extent of asset-quality problems will provide regulators with more visibility on the financial health of the banking system and enable implementation of effective support measures.

The banking sector's NPL ratio decreased to 8.9% as of 30 September 2020 from 12% a year earlier despite disruptions caused by the coronavirus pandemic. The decline was driven by the loan moratorium and the prohibition on banks downgrading loans until December 2020, which delayed the recognition of NPLs.

With the loan moratorium expiring at year-end 2020 and borrowers' debt repayment capacity weakened as a result of the coronavirus shock, we expect the systemwide NPL ratio to increase in coming quarters (see exhibit). The extent of NPL formation will, however, depend on banks' willingness to extend loan repayment periods and the effectiveness of stimulus measures announced last year.

NPLs were stable in 2020 despite disruptions caused by the coronavirus pandemic



Source: Bangladesh Bank

The true asset quality of loans will emerge across all sectors and we expect significant pressure in loans to vulnerable sectors such as the ready-made garment (RMG) and textile sectors. These two sectors accounted for 19.4% of banking system loans at the end of 2019. During the nine months to 30 September 2020, RMG-related exports fell by 19.8% from the year-earlier period. We also expect loans in sectors such as cement manufacturing and tanneries to contribute to asset-quality stress because they have yet to recover from the economic slowdown.

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Jackson Financial's separation from parent Prudential is credit negative

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On 28 January, [Jackson Financial, Inc.](#)'s (Baa2 negative) ultimate parent, [Prudential Public Limited Company](#) (A2 negative), announced that it will demerge its US business in the second quarter as it focuses on high-growth opportunities in Asia and Africa. While Jackson has not previously relied on its parent for capital support, the demerger is credit negative because Jackson will no longer have the potential backing of a strong parent in case of need.

As Jackson prepares for life as a public company, it will need to rebuild capital to support its businesses. Jackson's focus on variable annuity (VA) products with guaranteed benefits give rise to equity-sensitive liabilities and expose it to significant asset-liability management risks.

Jackson has a leading position in the US asset accumulation business, strong asset quality and good historical profitability. However, it also has significant exposure to earnings and capital volatility from equity markets and must manage capital requirements that are sensitive to policyholder behavior, equity market returns and interest rates.

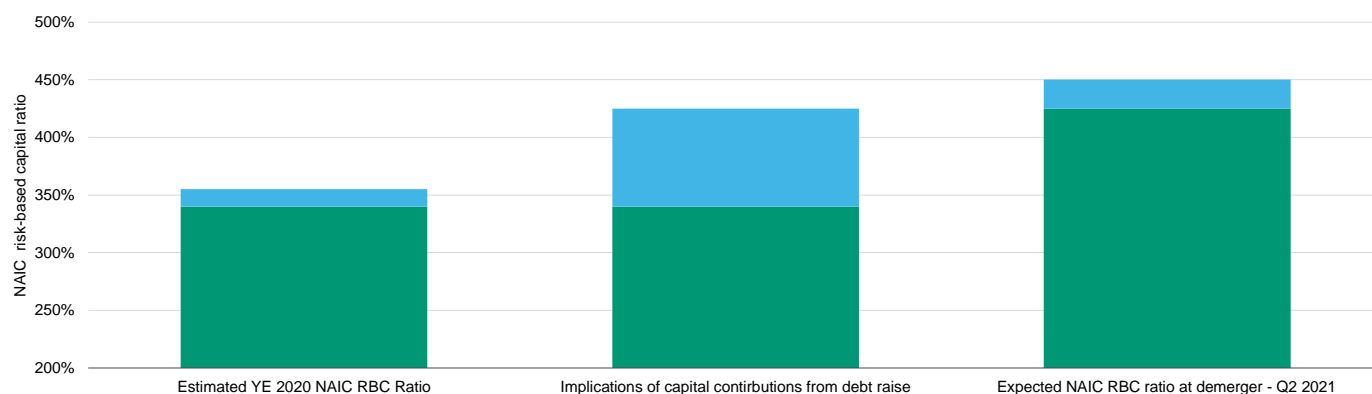
In particular, the complexity, risks and volatility of its variable annuity liabilities necessitate an elaborate hedging program that cannot fully eliminate a significant adverse effect on the group's capital in the event of severe market turbulence. Jackson has been able to implement new VA capital and reserve standards and hold equity exposure and market volatility at bay with hedging programs protecting statutory capital. However, recent volatility in its risk-based capital ratio highlights the need for high capitalization, the backing of a strong parent, or both.

The demerger sets the stage for Jackson to issue debt and secure appropriate credit facilities to improve its liquidity, particularly in times of stress. Furthermore, the additional disclosure and market discipline of being a public company will improve transparency, and provide greater information surrounding the company's business strategy.

Jackson expects to report a National Association of Insurance Commissioners (NAIC) company action level risk-based capital ratio of around 340%-355% for year-end 2020 (see exhibit). The ratio is lower than anticipated because of a change to the company's hedge modeling embedded in its variable annuity model assumptions that results in a decline of around 80 percentage points to its risk-based capital ratio. To offset the decline in capitalization, Jackson plans to issue debt and contribute the net proceeds to its insurance subsidiaries and support holding company liquidity. However, the increase in debt will raise its pro forma adjusted financial leverage to 25%-30% at the time of the demerger, which is more than the 20% or lower level we expect.

Jackson expects an NAIC company action level risk-based capital ratio of 425%-450% at the point of separation from Prudential. This will allow the company to improve its capital adequacy and offset potential volatility from its variable annuity business (see exhibit). We also expect adjusted financial leverage to decrease over time, and that Jackson will maintain a solid hedging program to proactively manage the risk of its variable annuity block.

Jackson will recapitalize its balance sheet to support growth in its variable annuity business



Sources: Company press release and Moody's Investors Service

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German Länder have record-high 2020 deficit amid coronavirus, but credit profile remains strong

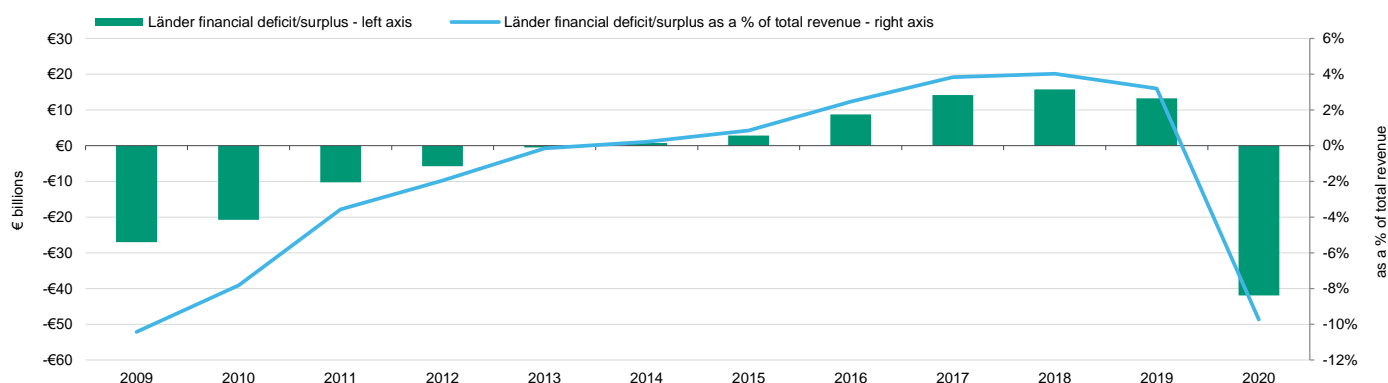
Originally [published](#) on 03 February 2021

On 29 January, Germany's Ministry of Finance published preliminary 2020 financial results of German Länder, which recorded a €41.9 billion financial deficit or 9.7% of total sector revenue, versus a 2019 surplus of €13.2 billion, or 3.2% of total revenue. The 2020 deficit is credit negative for the Länder, whose budgets we expect to remain pressured in the coming years. Nonetheless, central government financial subsidies, forward-looking financial management and favorable capital market conditions position Länder governments to weather budgetary challenges from the pandemic.

On a sector aggregate basis, the 2020 deficit was the Länder's highest financial deficit in nominal terms since the 2009 global financial crisis, when it was €27 billion (Exhibit 1). In relation to budget size, the Länder sector concluded 2020 very similarly to 2009, with financial deficits of 10% of total revenue. The posted financial deficit of €42 billion was about half that of our initial forecasts from spring 2020.

Exhibit 1

Länder (sector) 2020 financial deficit of €42 billion is weakest since 2009



Sources: German Ministry of Finance and Moody's Investors Service

With the evolving pandemic and the related slowdown of economic activity, uncertainty around 2020 budgetary planning and execution is reflected by individual Länder and central government approved supplementary budgets over the course of the year. The better-than-expected outcome mainly reflects significant central government financial subsidies to mitigate the jump in Länder's total expenses. A 5% decline in 2020 tax revenue is below our initial 8% forecast since the pandemic's effect on Germany's economy was mitigated by a dynamic third-quarter recovery.

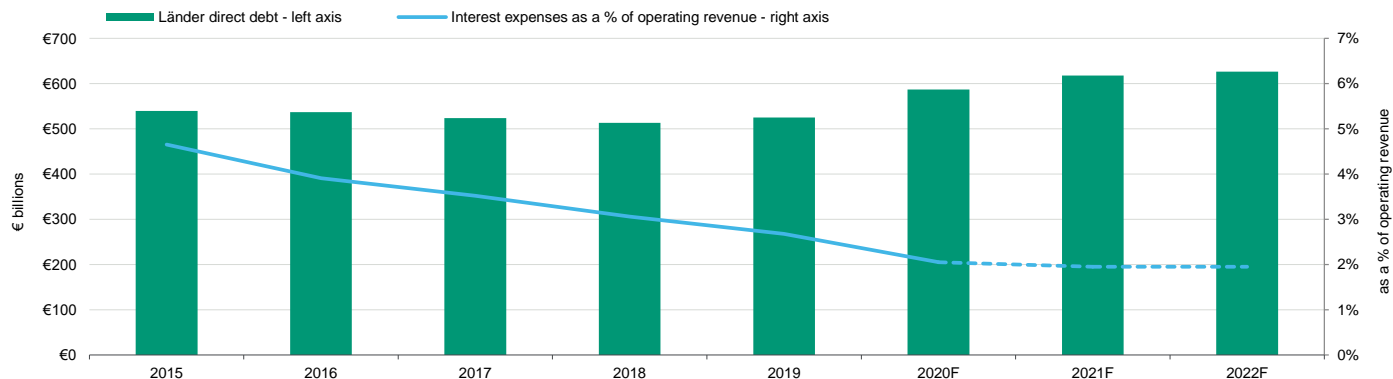
The 2020 financial deficit of €42 billion compares with Länder parliament-approved net funding allowances (or authorizations) of more than €100 billion in 2020. In many cases any unused parliamentary approved allowances can be used in future years to cover pandemic-related cost or tax revenue shortfall. For example, [Nordrhein-Westfalen](#) (Aa1 stable) in March announced a €25 billion special fund (NRW-Rettungsschirm), of which around €8 billion was used to cover the financial deficit. We expect such pre-approved allowances will allow Länder governments to fund pandemic-related cost and revenue losses in the coming years, which reflects the flexibility and autonomy of their budgeting policy.

We expect Länder financial performance this year to remain under pressure because of uncertainty around the economic recovery, which depends on effective health crisis management, the speedy distribution of coronavirus vaccines and central government policy support. Germany is trailing the distribution of vaccines internationally and the virus' resurgence has required repeated lockdowns.

However, we anticipate that the central government will continue to provide sizeable fiscal support. Crucially, the low interest cost (Exhibit 2) and Länder's excellent access to capital markets indicates that debt is well affordable.

Exhibit 2

Länder's interest costs are lower despite increasing debt burden



Note: 2020-22F is Moody's forecast.

Sources: Germany Ministry of Finance, German Statistics Office and Moody's Investors Service

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Special Affordable Care Act enrollment period is positive for hospitals, health insurers

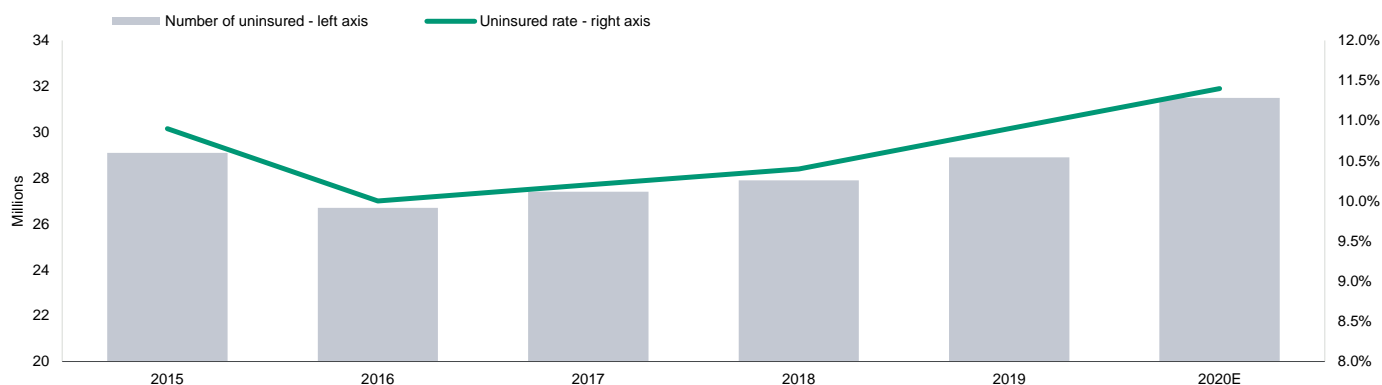
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On 28 January, US President Joseph Biden used an executive action to expand access to health insurance through a special Affordable Care Act (ACA) enrollment period for the next three months, a credit positive for hospitals and health systems.

The action will benefit hospitals by facilitating insurance coverage, reducing the number of uninsured or underinsured patients and promoting volume and business recovery, which generally remains below pre-pandemic levels. Increased enrollment would also be credit positive for health insurers, though high deductibles associated with exchange plans and financial hardship may still limit those who sign up for insurance.

The special enrollment period will run from 15 February through 15 May and open the federal exchange to those who have either lost or are unable to obtain health insurance through their employment, a population that has risen in recent years (see exhibit). To maximize the effect of the special enrollment period, the administration will allocate aid to help with outreach and advertising.

Special enrollment period will create access to a rising uninsured population



Sources: Moody's Investors Service, Kaiser Family Foundation and Robert Wood Johnson Foundation

The expansion period will help improve hospital payor mixes, which is important to profitability. Patients who lost health insurance during the pandemic generally shifted to Medicaid or uninsured/self-pay status, which are often reimbursed at much lower rates, from being commercially insured. Uninsured and self-pay patients are also associated with higher levels of bad debt, which hurts margins. Reinstated coverage and higher enrollment will limit increases in bad debt, although reimbursement and profitability ultimately depend on the contracts that hospitals have executed or signed for products available on the exchange. With rising healthcare costs continuing to outpace wage growth and many household budgets squeezed, many even with insurance coverage will struggle to pay for care, including insurance premiums and deductibles, which could continue to contribute to some level of bad debt.

The action also directs federal agencies to reconsider and reexamine policies that limit access to healthcare, such as protections for preexisting conditions, Medicaid work requirements and financial assistance programs. This is a departure from policies under the Trump administration that aimed to dismantle parts of the ACA that were more credit negative for hospitals.

Health insurers with a significant presence in the ACA market will also benefit from the executive action. We estimate that approximately 11.4 million people are enrolled in the individual market in 2021, but a study by the Robert Wood Johnson Foundation estimates that the number of uninsured as of 2020 is 31.5 million. While 73.7% of the uninsured cite high costs as the reason and might not respond to a special enrollment period, an analysis by the Kaiser Family Foundation found that more than half of the non-elderly uninsured population – nearly 16 million people – were eligible for Medicaid or other public options, free Bronze plans or

subsidized coverage in 2019. The main beneficiaries of the order would be the companies with the largest ACA footprints, including [Centene Corporation](#) (Ba1 stable), [Anthem, Inc.](#) (Baa2 stable) and [Health Care Service Corporation](#) (A3 stable).

When the ACA was first rolled out in 2014, the health insurance industry proceeded to lose billions of dollars over the next three years. This was because the ACA attracted fewer and sicker individuals than had been anticipated. While a significant expansion of the ACA could once again affect the risk pool, health insurers are likely to be better prepared than before to handle it because of better plan design and better pricing.

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CREDIT IN DEPTH

Banks' loosening of consumer underwriting standards will likely continue in 2021

Originally [published](#) on 02 February 2021

In this pulse of the consumer report¹, we provide key take-aways from the latest quarterly Senior Loan Officer Opinion Survey (SLOOS), released 1 February.

The latest SLOOS reveals that bank consumer lenders loosened underwriting standards for credit cards, auto loans and residential mortgages in the fourth quarter, as consumer loan asset quality remained very solid.² The easing of consumer underwriting standards varied across the three asset classes, but net loosening for consumer loans overall was the largest since 2015 driven largely by credit cards and to a lesser extent auto loans. Further, consistent with our expectations, banks reported high likelihood of continued loosening of underwriting standards for credit cards, auto loans and residential mortgages in 2021, citing, in particular, the prospect of improvement in credit quality.

Net loan demand for credit cards was flat in the fourth quarter, declined for auto loans and remained strong for residential mortgage loans. With mortgage rates at historic lows, demand for residential mortgages should remain high in 2021, as homeowners look to refinance their existing mortgages as well as purchase new homes. We expect credit card demand to also pick up after card balances declined more than 10% in 2020.

The exhibit below summarizes underwriting standards and trends for credit cards, auto loans and residential mortgages, including the current quarter SLOOS results and our projections.

Loosening in underwriting standards across consumer loan categories in Q4 is likely to continue in 2021, although we expect loan performance will weaken modestly

Q4 underwriting standards compared with historical standards

	Current quarter's Senior Loan Officer Opinion Survey results	Moody's projected trends
Credit cards	Loosening	As economic environment improves, expect loosening; Still elevated unemployment will weaken loan performance modestly
Auto loans	Modest loosening	As economic environment improves, expect loosening; Still elevated unemployment will weaken loan performance modestly
QM jumbo residential mortgages	Very modest loosening	As economic environment improves, expect loosening; Still elevated unemployment will weaken loan performance very modestly
Legend:		
Credit negative	Modest credit negative	Neutral

Sources: Federal Reserve and Moody's Investors Service

[Click here](#) for the full report.

Endnotes

¹ Each quarter we publish three pulse of the US consumer reports analyzing: 1) consumer loan performance in the current quarter for the largest US banks, 2) senior loan officer survey results and 3) the New York Federal Reserve Bank's Household Debt and Credit report results

² Two caveats to the implications of the survey responses are that they reflect only the banks' own view of their underwriting and that non-banks, which are not surveyed, have material market shares in auto loans and residential mortgages.

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