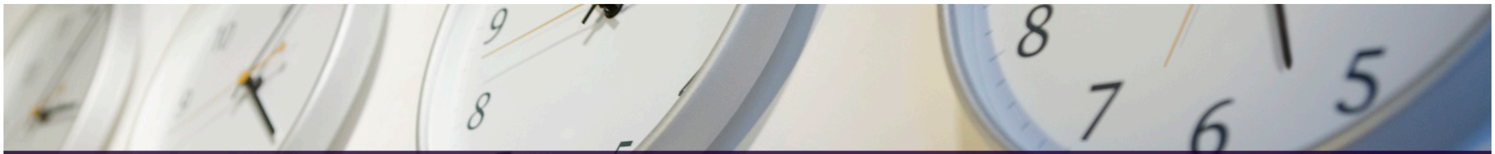

Credit Outlook

8 April 2021

NEWS AND ANALYSIS

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WME IMG parent's IPO, purchase of UFC, would be credit positive

On 31 March, Endeavor Group Holdings Inc., the parent company of WME IMG LLC (B3 negative), said it would pursue an initial public offering (IPO) with the net proceeds in part going to fund the purchase of 49.9% of mixed martial arts (MMA) business UFC Holdings LLC that it does not already own, as well as for generate corporate purposes and debt repayment.

An IPO by Endeavor would be credit positive for WME IMG, with potential debt repayment helping reduce the media and talent management agency's extremely high leverage, which was exacerbated by the coronavirus pandemic's effects on operations. WME IMG would also benefit from the implied financial support that UFC would provide, although UFC will not be a guarantor to WME IMG's credit facility. Endeavor pulled a previously planned IPO in 2019.

UFC has performed well during the pandemic given the ability to hold MMA events where coronavirus infections were lower than in other areas, or where localities had less-restrictive heath restrictions. The limited number of participants in MMA events, compared with other professional sports leagues, also reduces infection risks. While many UFC events in 2020 were held with few or no fans, in-person attendance is a modest portion of the sport's revenue, and it continued generating strong results via long-term media and pay-per-view deals. The results allowed UFC to make distributions to shareholders, including Endeavor, which used the proceeds to support WME IMG's liquidity in 2020. Endeavor buying the remainder of UFC would increase the amount of UFC's relatively stable free cash flow available to support WME IMG if needed. WME IMG reported about $2.9 billion of revenue for the 12 months that ended in September 2020.

We also expect WME IMG's governance to improve if Endeavor goes public, with more detailed and transparent financial reporting and quality of information, although Endeavor's segment reporting is likely to differ from the financial reporting of WME IMG's and UFC's credit groups. Endeavor's owned sports properties division will include operations from UFC as well as WME IMG. Endeavor will also be a controlled company with members of management and private-equity firm Silver Lake Partners as equity holders controlling more than 50% of the voting power through a dual-class share structure.

William Morris Endeavor Entertainment LLC bought IMG Worldwide Holdings LLC in 2014 for about $2.4 billion with about $461 million in financing from Silver Lake. The company provides client representation, event operations, distribution of media, sponsorship and licensing rights.

Endeavor is likely to pursue a more conservative financial policy as a public company, with the goal to reduce net leverage. Historically, WME IMG and UFC frequently issued additional debt to help fund acquisitions or pursue equity friendly transactions that benefited the private-equity sponsors and hurt both companies' credit metrics. Stock compensation and partner distributions at WME IMG were high historically and the company used its balance sheet to provide liquidity to employees to monetize a portion of their equity holdings. While stock compensation will likely remain high relative to other corporations following an IPO, the partner distributions are likely to decline and employees will be able to sell their shares on the open market.

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Pioneer's DoublePoint acquisition enhances free cash flow generation, scale

Originally published on 05 April 2021

On 1 April, Pioneer Natural Resources Company (Baa2 stable) announced an all-stock acquisition of DoublePoint Energy, LLC, the parent of Double Eagle III Midco 1 (B2 review for upgrade), for $6.4 billion, a credit positive. DoublePoint's largely undeveloped Midland assets are highly complementary to Pioneer's and the transaction enhances Pioneer's already considerable inventory of high-quality acreage there, while also providing cost savings and increased scale. The transaction is being funded with $4.5 billion of equity, $1 billion of cash and includes Pioneer's assumption of DoublePoint's $900 million of debt.

Pioneer will issue 27.2 million shares of common stock in the transaction. After closing, existing DoublePoint owners will own approximately 11% of the combined company. Pioneer plans to finance the cash portion of the purchase price through a combination of cash on-hand and borrowing under its revolving credit facility. The transaction has been approved by Pioneer's board of directors and the company expects it to close in the second quarter of this year.

The combination will provide significant cost savings opportunities; Pioneer estimates annual operating savings and efficiencies of $100 million and G&A savings of $15 million. Pioneer also expects to be able to reduce its combined interest burden by $60 million annually by calling DoublePoint's debt when it becomes callable at par at year-end 2022. The good overlap between the two companies' asset bases will provide Pioneer with significant operating efficiencies and enable longer horizontal laterals, boosting well productivity and improving margins and returns. The transaction, along with the recently completed acquisition of Parsley Energy, enhances Pioneer's ability to generate considerable free cash flow after years of outspending. As a result, Pioneer will likely be able to generate free cash flow sufficient to repay its upcoming debt maturities through 2024, including calling DoublePoint's notes at the end of 2022 if it chooses to do so.

The addition of DoublePoint's oil-weighted production, expected to reach 100,000 barrels of oil equivalent/day (boe/d) by the end of the second quarter, adds to Pioneer's position as a top-tier producer in the Permian Basin, with pro forma production likely to exceed 650,000 boe/d in the second half of this year. DoublePoint's slightly oilier production mix will enhance Pioneer's margins and generate substantial free cash flow. DoublePoint had grown tremendously during its relatively short existence and the recent vintage of its wells will require greater capital intensity to maintain production than Pioneer's legacy production. As a result, Pioneer will only drop two of DoublePoint's seven currently operating rigs over the remainder of 2021, as it seeks to prioritize free cash flow generation and a sustainable asset base with low cost of supply over absolute growth.

Irving, Texas-based Pioneer Natural Resources Company is a large independent oil and natural gas exploration and production company operating in the Midland and Delaware sub-basins of the Permian Basin.

Double Eagle III Midco 1 LLC is wholly owned by DoublePoint Energy, LLC, which is a Fort Worth, Texas-based private exploration and production company that was formed in June 2018 with operations in the Midland sub-basin of the Permian Basin.

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Brazil’s central bank authorizes Facebook's money transfer service, adding negative pressure to incumbent banks

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On 30 March, Banco Central do Brasil (BCB), Brazil’s central bank, authorized Facebook Inc. to offer its clients in Brazil new payment services through its cross-platform messaging and voice-over-IP service WhatsApp, which will be linked to Facebook Pay. The roll-out of transfers between individuals via Facebook Pay in Brazil adds negative pressure to banks’ fee earnings from payment services. No date has yet been set for the system’s launch.

Brazilian incumbent banks have traditionally made fee income from money transfers between individuals and companies, from which they have charged a fixed fee, as well as from card payment processing. The banks are vertically integrated and are both card issuers and have payment acquiring units.

In November 2020, the BCB launched its own instant payments transfer system called PIX, which provides peer-to-peer money transfers and the ability for individuals to transfer the cost of goods and services to merchants. PIX's explicit aim was to reduce the cost of transfers and to stimulate financial inclusion and has already led to Brazilian banks recording a sharp fall in fees they previously made from money transfers. The upcoming launch of transfers via WhatsApp will reach a large number of WhatsApp users, adding further pressure to an already competitive segment.

Under the WhatsApp payment arrangement, users will register their Visa Inc. (Aa3, stable) or Mastercard Incorporated (A1 stable) branded cards with Facebook Pay, allowing them to make transfers between individuals via WhatsApp at no cost. The new platform will also enable Facebook to monitor money transfers over time, likely giving Facebook the opportunity to leverage other financial services beyond payments, a strategy that could speed up with the implementation of open banking in Brazil this year. Additional digital disruption to Brazil's banks caused by Facebook’s expansion would also be credit negative.

The BCB has not authorized the use of Facebook Pay to make payments to merchants for the acquisition of goods and services. Should the central bank allow this function, nonparticipating banks would face even more pressure on the fees they generate from card payment processing as payment volumes migrate to Facebook Pay via WhatsApp.

WhatsApp is currently used by almost 120 million individuals in Brazil – a number larger than the total number of banking clients in the country – and it is used for both private and commercial use. Such widespread usage has the potential to increase financial inclusion, an ancilliary aim of the WhatsApp transfer system, and a key factor behind BCB's agenda to increase efficiency of the financial system.

Facebook originally set up a payment service company in Brazil in June 2020 in partnership with Banco do Brasil S.A. (Ba3/(P)Ba2 stable, ba2[1]), Banco Cooperativo Sicredi S.A. (Ba2 stable, ba2), Cielo S.A. (Ba1 stable), Visa and Nu Pagamentos S.A. (Nubank). However, on 23 June, the central bank and Brazil's competition authority CADE suspended Facebook's payment system, eight days after the payment system launched, to give the regulators time to evaluate possible risks to competition, efficiency and data privacy in the Brazilian payments system.

Endnotes

1 The ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

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Caixa pact to sell Banco Pan stake to BTG Pactual is credit positive for both banks

Originally published on 06 April 2021

On 6 April, Brazil's state-owned bank Caixa Economica Federal (Caixa, Ba2 stable, ba3[1]) announced that it will sell its 49.19% common equity stake in consumer lender Banco Pan S.A. to BTG Pactual Group for BRL3.7 billion. If the sale, which is subject to regulatory approval, proceeds, it would be credit positive for Caixa because it would primarily benefit its capital structure and operating efficiency. The transaction would also be credit positive for investment bank Banco BTG Pactual S.A. (BTG Pactual, Ba2/(P)Ba2 stable, ba2), BTG Pactual Group's main operating company, because it would reinforce the bank's digital strategy into retail banking, enhancing its earnings profile by reducing profit volatility, a common feature of investment banks.

The sale would allow Caixa to continue amortizing its stock of hybrid debt, which as of December 2020 totaled BRL31.8 billion or the equivalent of 45% of Caixa's common equity. Since 2019, Caixa has committed to the payment of outstanding hybrid instruments owed to the government. In 2019, Caixa paid BRL11.35 billion using proceeds from the sale of its stake in Petroleo Brasileiro S.A. - PETROBRAS (Ba2 stable) and from other non-recurring gains related to the insurance distribution agreements closed with French insurance firm CNP Assurances (A1 stable).

Since 2019, Caixa has been divesting noncore assets, including selling its preferred stake participation in Banco Pan in a transaction that concluded in August 2020. The divestments are part of a reshaping strategy focused on enhancing Caixa's footprint in social lending and mortgages.

Combined with the contraction of its lending operations to noncore segments such as large corporations, this strategy has allowed the bank to improve its capitalization, which reached a ratio of tangible common equity to risk weighted assets[2] of 9.33% at the end of 2020, well above Caixa's previous range of 5%-6%.

In 2020, however, Caixa's loan book resumed its growth, expanding 13.52% during the year as part of a strategy that focused on helping small and midsize enterprises (SMEs) and individuals most affected by the coronavirus pandemic. The growth primarily derived from disbursements under government-sponsored credit facilities created to address immediate liquidity needs of SMEs severely affected by a sudden drop in sales caused by social-distancing measures. The growth also came from loan deferrals and relief extended to individuals, mainly mortgage customers that were able to postpone payments due during 2020.

Meanwhile, becoming Banco Pan's sole shareholder will enable BTG Pactual to complement its retail banking platform BTG+, which launched in 2018 primarily to focus on servicing digital products to high net worth individuals, and to leverage operating synergies such as IT solutions that can lead to cost savings for both banks. Banco Pan, which has a digital operation focused on providing financing to the acquisition of preowned car and payroll-deductible loans, will remain an independent business from BTG Pactual. Banco Pan will enhance BTG Pactual's revenue structure by increasing recurring earnings, with potential synergies for its funding base. In addition, since 2016, BTG Pactual has been increasing fee-based revenue by expanding wealth and asset management activities, segments in which BTG Pactual has strong market position in Brazil. This strategy aids in reducing the bank's intrinsic earnings volatility.

Caixa's wholly-owned subsidiary Caixa Participaçoes S.A, which manages its equity stakes, holds its Banco Pan stake. According to the announcement, this sale of common shares is expected to generate a onetime net profit close to BRL1.6 billion for Caixa and the divestment will also reduce capital allocation benefiting capitalization.

Separately, Caixa on 6 April announced the market price range of between BRL9.33 and BRL12.67 per share for the upcoming initial public offering (IPO) of its insurance subsidiary, Caixa Seguridade. Caixa expects to sell up to 17.25% of Caixa Seguridade, which at the midpoint of the range would equal nearly BRL5 billion. Caixa plans to conclude the transaction in the coming months, depending on local capital market conditions. The bank suspended the IPO process last year because of high market volatility triggered by the coronavirus pandemic.

Endnotes

1 The ratings shown are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

2 Our preferred capital metrics consider tangible common equity, adjusted by excluding part of the deferred tax assets related to temporary differences on loan-loss provisions, as a percentage of risk-weighted assets, that is adjusted to include Brazilian government bonds weighted at 100%, which takes into account Brazil's Ba2 rating.

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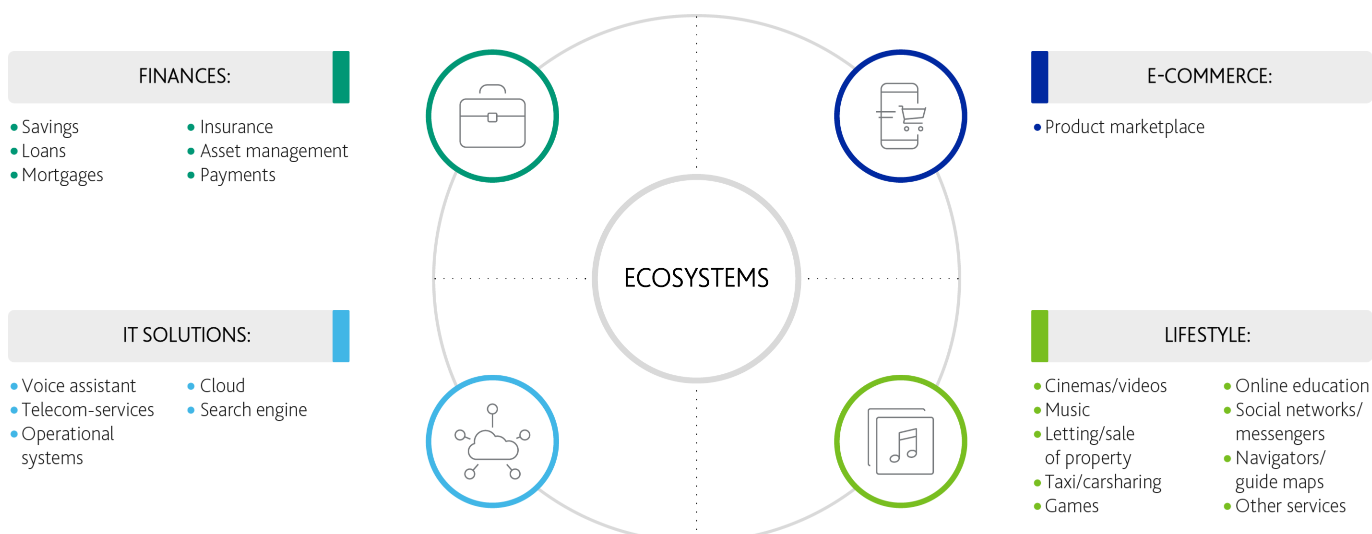
Russia's proposed regulation on financial ecosystems would negatively affect some banks' business models

On 2 April, the Central Bank of Russia (CBR) published a consultation paper as part of a proposal to introduce several regulatory measures. The measures aim to improve financial market competition and prevent the emergence of dominant financial ecosystems, defined as technology platforms that enable banks or third-party service providers to offer a full range of services for customers controlled by ecosystem owner.

The proposal would be credit negative for several large Russian banks developing ecosystems because the regulatory measures risk giving smaller banks' access to larger banks' multimillion-person customer base and ecosystems, undermining the largest banks' market positions. Additionally, an open ecosystem model and a requirement that ecosystems provide equal access to a wide range of third-party suppliers has the potential to negatively affect the largest ecosystems' bargaining power and ultimately their profitability. The CBR has initiated a public discussion with banks and financial institutions that ends on 1 June 2021.

Exhibit 1 describes the types of financial and nonfinancial services that ecosystems provide. Currently, Russian banks developing ecosystems include Sberbank (Baa3 stable, ba1[1]), Bank VTB, PJSC (Baa3/Baa3 stable, b1) and Tinkoff Bank (Ba3/Ba3 stable, ba3), as well as nonfinancial companies such as Yandex, Mail.ru group and Mobile TeleSystems PJSC (Baa3 stable).

Exhibit 1
Ecosystems provide a wide range of financial and nonfinancial products and services



Source: Central Bank of Russia

Among the key regulatory initiatives mentioned by CBR are the following:

» A requirement to have an open ecosystem model to provide equal opportunities to a wide range of suppliers of financial and nonfinancial products and services at their online platforms

» Prevention of tariff, information or operational discrimination of any third-party supplier

» Mandatory introduction of an open or publicly available application programming interface (API) by ecosystems that allows customers and suppliers to easily switch between different online platforms and ecosystems

- Easing customers' and suppliers' ability to switch between platforms and ecosystems to improve the competitive environment and provide for better price and quality of financial and nonfinancial products
- Focus by ecosystems on protecting customers' personal data and managing cyber risks
- Regulations will be proportional to the size and systemic importance of the ecosystem operator, its effect on the economy and potential risks stemming from that operator's activities

The CBR's proposal to open ecosystems to other market participants (banks or financial institutions) is based on criteria publicly disclosed by the ecosystems. Additionally, in order to eliminate information discrimination, the CBR has deemed it necessary to open the data collected by the ecosystems for all competing suppliers. Given that aggregated, rather than personalized, data is subject to disclosure, the ecosystems will continue to serve specific users, but will lose a competitive advantage of assessing consumers behavior patterns and related risks.

Financial services of the largest Russian ecosystems are mostly provided under closed ecosystem business models that imply that only the owner or its related companies or partners can be suppliers of products or services for the ecosystem's customers (see Exhibit 2). If the new regulation is introduced as proposed, it has the potential to undermine this business model, erode the profitability of the largest players and slow development of local ecosystems.

Exhibit 2

Most of the local ecosystems' components have closed model which locks the customer base within their borders

⚙ Closed model 🌐 Open model

OWNER OF ECOSYSTEM	FINANCES		IT SOLUTIONS	E-COMMERCE	LIFESTYLE	
	Payments	Other financial services			Content	Services
SBERBANK	⚙ Sber	⚙ Sber	⚙ SberDisk	⚙ Sberlogistika 🌐 SberMarket, Goods.ru	⚙ Lenta.ru 🌐 Okko	⚙ Youdrive 🌐 SberFood
YANDEX	⚙ Yandex Pay	⚙ Yandex Plus. Account	⚙ Disk	🌐 Yandex Market	⚙ Practicum 🌐 Music	⚙ Drive 🌐 Auto.ru
TINKOFF BANK	⚙ Tinkoff	⚙ Tinkoff	⚙ Tinkoff Mobile	🌐 Goods.ru	⚙ Tinkoff Education 🌐 Cinema	🌐 Turbo
MAIL.RU GROUP	⚙ Money.Mail.ru	⚙ VK Pay	⚙ Cloud Mail.ru	🌐 Youla	⚙ Skillbox 🌐 Boom	⚙ Citimobil 🌐 VK (Vkontakte)
BANK VTB PJSC	⚙ VTB	⚙ VTB 🌐 Square Meter	⚙ VTB mobile	⚙ ComissiON		⚙ Smart sms 🌐 Square meter
MOBILE TELESYSTEMS PJSC (MTS)	⚙ MTS Bank	⚙ MTS Bank	⚙ MTS	⚙ MTS Online Store	⚙ Razvivaika 🌐 MTS TV	⚙ SmartMed 🌐 MTS Music

Source: Central Bank of Russia

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

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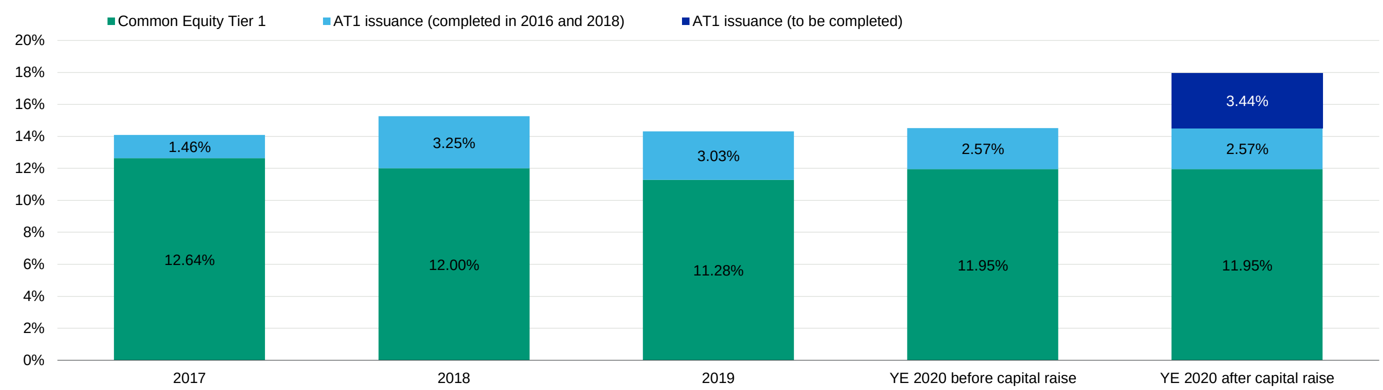
Oman Arab Bank's Additional Tier 1 issuance will be credit positive

Originally published on 06 April 2021

On 31 March, Oman Arab Bank S.A.O.G (Ba3 negative, ba3[1].) announced that its shareholders at a 28 March extraordinary general meeting approved the issuance of OMR97 million ($251 million) of Additional Tier 1 (AT1) securities over the next five years. The credit-positive AT1 issuance will increase Oman Arab Bank's regulatory Tier 1 capital ratio and support its liquid resources amid Oman's tight funding and liquidity conditions.

The bank issued two AT1 perpetual bonds previously: one of OMR30 million in December 2016 and one of OMR42.5 million in October 2018. We estimate that Oman Arab Bank's regulatory Tier 1 capital will increase to 17.96% on a pro forma basis from 14.52% reported at year-end 2020 (see exhibit). Tier 1 capital exceeds the 2020 Basel III minimum requirement of 10.25%, as the Central Bank of Oman's 18 March 2020 circular relaxed the capital conservation buffer requirement to 1.25%, reducing Tier I capital ratio minimum requirements from previous 11.5%.[2]

Oman Arab Bank's reported Tier 1 capital ratio



Source: Oman Arab Bank

The issuance will increase the bank's regulatory loss-absorption buffers as subdued economic growth and extended payment cycles weaken loan performance. Oman Arab Bank's problem loans were 4.1% of gross loans at year-end 2020, versus 3.3% at year-end 2019 and 2.3% at year-end 2018.

Given the Central Bank of Oman's phased-in implementation of the Basel III capital conservation buffer in the form of Common Equity Tier 1 capital (as opposed to AT1 capital), we expect Oman Arab Bank to support its tangible common equity (TCE) ratio mainly through profit retention. Arab Bank's policy of managing capital at the group level will also constrain the bank's capital levels. The bank's TCE to risk-weighted assets ratio was 11.7% at year-end 2020 (stable at this level since year-end 2019), well below the 13.8% system average. Our TCE ratio calculation excludes AT1 instruments with a discretionary trigger mechanism, and increases risk weights on local sovereign debt securities in Oman to reflect the Basel standardised framework. The bank reported a total capital adequacy ratio of 15.42% and Common Equity Tier 1 of 11.95% at year-end 2020, and a ratio of shareholder's equity (excluding Tier 1 capital notes) to total assets of 10.9%. Oman Arab Bank's capital remained broadly unchanged following the merger and consolidation of Alizz Islamic Bank in June 2020.

The AT1 issuance also supports Oman Arab Bank's modest liquidity buffers. The bank's liquid banking assets were 15.9% of tangible banking assets at year-end 2020 (versus 15.3% as of year-end 2019 and 17.6% as of year-end 2018), which is below the 23% local average. However, the bank's market funding was a modest 0.9% of tangible banking assets at year-end 2020, well below the 11.4% local average. The bank's ratio of net loans to deposits slightly declined to 96% at year-end 2020 from 100% as of year-end 2019. This reflected higher deposit growth (at 38% during 2020) than loan growth (31% during the same time) mostly inorganic as the group consolidated assets of Alizz since June 2020. This ratio is lower than the local average of 104%.

Oman Arab Bank's total assets of OMR3.3 billion at year-end 2020 constituted a 10% market share in Oman by assets.

Endnotes

1 The bank ratings in this report are Oman Arab Bank's deposit ratings and Baseline Credit Assessment

2 The 11.5% ratio included a 7% minimum CET1 capital ratio, 200 basis points (bp) maximum in Additional Tier 1 capital and a 250 bps capital conservation buffer (CCB) in the form of CET1 capital.

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Algeria's extension of regulatory relief measures will soften the pandemic's impact on banks

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On 1 April, Algeria's central bank announced the extension of measures to reduce the adverse effects of the coronavirus pandemic on the country's economy and banks. The measures will help limit local banks' asset quality deterioration. The extension is the third since the measures were introduced on 6 April last year and will last until 30 June.

The measures include the postponement or rescheduling of loan installment payments from customers negatively affected by the pandemic and an extension of credit to customers already benefiting from postponement or rescheduling measures. They also include a reduction in banks' minimum liquidity and minimum regulatory capital ratios.

The measures will help limit banks' asset quality deterioration in the current environment by supporting the broader economy and keeping some borrowers' liquidity challenges from becoming solvency issues as banks extend support to borrowers. Lending rose by 3.1% in 2020 compared with 8.8% in 2019. However, should pandemic-related economic challenges last for more than a few more quarters, the additional lending provided by the banks would raise long-term risks as some borrowers face solvency issues.

Such asset quality deterioration would increase already high systemwide problem loans. According to the latest available data, systemwide gross nonperforming loans accounted for 12.3% of total loans in December 2017, partly reflecting government arrears amid volatile oil prices given Algeria's status as an oil-exporting country. The International Monetary Fund in October 2020 estimated that a relatively large stock of legacy problem loans was potentially under-provisioned.

We expect the pandemic to have the greatest impact on borrowers in the trade and transportation sectors, and small and midsize enterprises are particularly vulnerable to economic shocks. As of December 2020, central bank data showed that the public sector accounted for 51.7% of systemwide lending, the private sector 48.3% and households 8.2%. Although the central bank does not report lending breakdown by economic sector, we estimate that services accounted for around 47% of GDP in 2017, the industry sector around 39% and the agriculture sector around 13%.

Nonetheless, Algerian banks benefit from sound capitalisation, which will provide some loss-absorption buffer. The provisional systemwide Tier 1 capital ratio was 14% as of September 2020, compared to a regulatory minimum of 7%. The banks' provisional capital adequacy ratio was 18% as of the same date compared to a 9.5% regulatory minimum. Algerian banks have historically exhibited healthy profitability, with a 2.0% return on assets in 2017 according to the latest available data.

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AmBank Group's private placement is credit positive

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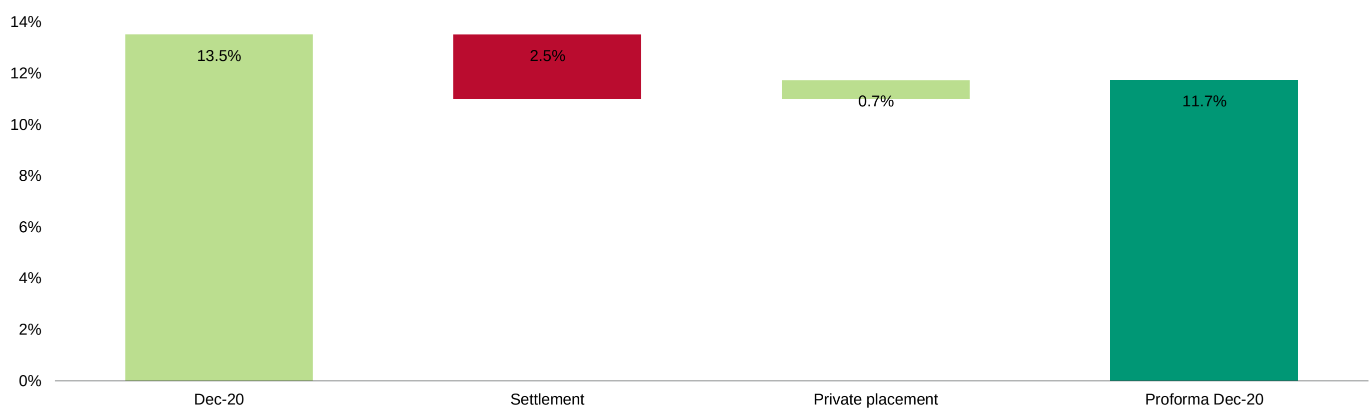
On 5 April, AMMB Holdings Berhad (AmBank Group) announced that it had successfully undertaken a private placement, which was oversubscribed. This is credit positive for AmBank Group and its main operating subsidiary AmBank (M) Berhad (AmBank, A3 negative, baa2[1]) because the capital raised will partially offset the reduction in capital as a result of its recent 1Malaysia Development Berhad (1MDB) settlement.

AmBank Group will raise MYR825 million ($200 million) through the issuance of 300 million shares, or around 10% of its share capital, at MYR2.75 a share. Most of the proceeds will strengthen AmBank's capital. More important, the private placement is evidence of AmBank Group’s commitment to restore its capital to presettlement levels.

The private placement followed a MYR2.8 billion settlement that AmBank Group reached with the Government of Malaysia (A3 stable) on 26 February 2021 in relation to its involvement in corruption at the state fund 1MDB. AmBank will absorb the bulk of the settlement.

As of 31 December 2020, we estimate that AmBank Group's pro forma Common Equity Tier 1 (CET1) ratio will fall to 11.7% from 13.5% after taking into consideration the net effect of the settlement and private placement, which is higher than we initially estimated by around 70 basis points because of the private placement (see exhibit). Similarly, AmBank's pro forma CET1 ratio will fall to around 12.0% from 13.3%. This CET1 ratio decrease also incorporates a separate capital injection from AmBank Group to offset part of the settlement.

Private placement will partially offset the reduction in AmBank Group's capital caused by the 1MDB settlement
Common Equity Tier 1 capital ratio



Sources: AmBank Group and Moody’s Investors Service

AmBank Group is also planning to write down MYR2.1 billion in goodwill that arose from legacy acquisitions. Nevertheless, the write-down will not affect AmBank Group’s liquidity and regulatory capital ratios because it is a noncash item, and the goodwill is already deducted for regulatory capital purpose, respectively.

Endnotes

1 The bank ratings shown in this report are deposit rating, senior unsecured rating (where available) and Baseline Credit Assessment.

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Vietnam's revised regulation on pandemic-led loan restructuring is credit negative for banks

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On 2 April, Vietnam's (Ba3 positive) central bank, The State Bank of Vietnam, issued Circular 03/2021 revising Circular 01/2020 on the restructuring of loans affected by the coronavirus pandemic. The revised regulation is credit negative for Vietnamese banks because it expands the scope of loans eligible for restructuring without correspondingly requiring banks to build up loan-loss provisions against these loans from day one. Unchanged from the previous circular, banks cannot book unearned income from restructured loans as accrued interest until borrowers make payments.

The revised regulation expands the scope of loans eligible for restructuring without being classified as nonperforming to include loans originated before 10 June 2020, as opposed to those originated before 23 January 2020 under the original regulation. Banks have until the end of this year to restructure loans to borrowers affected by the pandemic.

Vietnamese banks will need to calculate the level of specific provisions required had the restructured loans not been allowed to remain in the performing categories. They will then be allowed to create the required specific provisions over three years – 30% in 2021, 60% in 2022 and 100% in 2023 – a change from the original regulation under which banks did not have to create specific provisions against restructured loans.

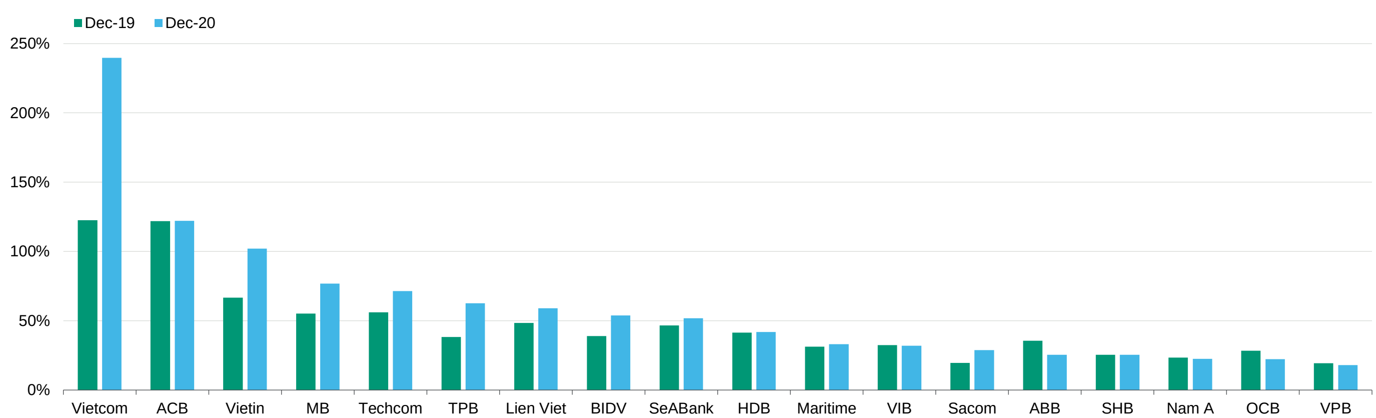
While a step in the right direction, the longer period for banks to build up provisions is credit negative, particularly in view of the wider scope of loans now eligible for restructuring. Vietnam's provisioning requirement is also less stringent compared with other banking systems; for example, Indian banks are required to make 10% provisions against restructured loans on day one. Banks that have adopted International Financial Reporting Standard 9 have also built up provisions to absorb potential increases in nonperforming loans in 2020.

We expect the staggered additional specific provisions requirements will have little impact on our rated banks' profitability, particularly when viewed in the context of Vietnam's improving macroeconomic environment. As of the end of 2020, total exposures to borrowers with at least one restructured loan was around 5% of our rated banks' gross loans. Many of our rated banks also boosted their provision coverage against problem assets in 2020 (see exhibit), though those that still have thin problem asset coverage will continue to face high credit costs in 2021.

Exhibit 1

Several rated banks increased their loan loss coverage in 2020

Loan-loss reserves as % of problem loans



Key: Vietcom = JSC Bank for Foreign Trade of Vietnam (Ba3 positive, ba3); ACB = Asia Commercial Bank (Ba3 stable, ba3); Vietin = Vietnam JSC Bank for Industry and Trade (Ba3 positive, b1); MB = Military Commercial Joint Stock Bank (Ba3 stable, ba3); Techcom = Vietnam Technological and Commercial Joint Stock Bank (Ba3 positive, ba3); TBP = Tien Phong Commercial

Joint Stock Bank (B1 positive, b1); Lien Viet = Lien Viet Post Joint Stock Commercial Bank (B1 stable, b2); BIDV = JSC Bank for Investment & Development of Vietnam (Ba3 positive, b2); SeABank = Southeast Asia Commercial Joint Stock Bank (B1 stable, b2); HDB = Ho Chi Minh City Development JSC Bank (B1 stable, b2); Maritime = Vietnam Maritime Commercial Joint Stock Bank (B2 stable, b3); VIB = Vietnam International Bank (B1 positive, b1); Sacom = Saigon Thuong Tin Commercial Joint-Stock Bank (B3 stable, caa1); ABB = An Binh Commercial Joint Stock Bank (B1 stable, b2); SHB = Saigon - Hanoi Commercial Joint Stock Bank (B2 stable, b3); Nam A = Nam A Commercial Joint Stock Bank (B2 stable, b3); OCB = Orient Commercial Joint Stock Bank (B1 positive, b1); and VPB = Vietnam Prosperity Joint Stock Commercial Bank (VPB, B1 positive, b1). The bank ratings shown in this exhibit are the bank's deposit rating and Baseline Credit Assessment.
Source: Moody's Investors Service

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Landmark sale leaves BrightSphere less diversified and more exposed to beta risk

Originally published on 07 April 2021

On 31 March, BrightSphere Investment Group Inc. (BSIG, Baa2 review for downgrade) announced that it plans to sell its 60% ownership interest in affiliate Landmark Partners LLC to Ares Management Corporation for $690 million before tax. The planned divestiture is credit negative for BSIG because it will result in reduced business diversification, higher equity market beta exposure and fewer organic growth opportunities, despite sale proceeds improving the company's liquidity at the transaction's close.

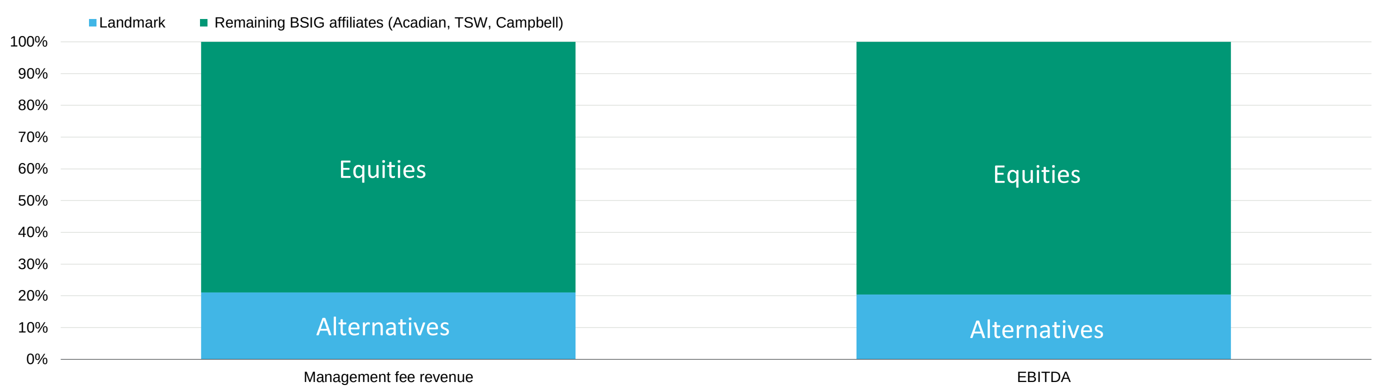
Ares is a publicly traded global alternative investment manager offering credit, private equity and real estate strategies. Ares is paying a 17.2x fee-related earnings multiple for BSIG's 60% ownership interest in Landmark. Ares has also agreed to acquire BSIG's co-investments in Landmark funds, which had a book value of approximately $34 million at year-end 2020. We believe the total consideration is a good value for BSIG's stake. The parties expect the transaction to close in second-quarter 2021, subject to customary closing conditions and regulatory approvals.

Founded in 1989 and acquired by BSIG in August 2016, Landmark is an alternative investments manager specializing in secondary market transactions of private equity, real estate and infrastructure funds and investments. As of year-end 2020, Landmark had $18.4 billion in assets under management (AUM), with management fee revenue of $146.8 million, and it contributed EBITDA of $42.2 million to BSIG.

Following BSIG's sale of Landmark, its AUM and management fee revenue will be almost entirely driven by its two affiliates – Acadian Asset Management LLC and Thompson, Siegel & Walmsley LLC (TSW) – which specialize in managing publicly traded equities. Therefore, BSIG's EBITDA going forward will be subject to much greater beta risk, also known as mark-to-market volatility, than it was in the past (see exhibit).

Exhibit 1

Post-Landmark sale, BSIG's revenue and EBITDA will be less diversified and highly sensitive to equity market moves



Management fees are based on 2020 audited financials and include amounts associated with the prior dispositions of Barrow Hanley and Copper Rock. BSIG's smallest remaining affiliate, Campbell Global, is an investment manager focused on timberland with $5 billion in AUM. Campbell's revenue and earnings are not significant compared to BSIG's two largest remaining affiliates, Acadian with $108 billion in AUM and TSW with $22 billion in AUM, that specialize in managing equities.
Sources: Company filings and Moody's Investors Service

For Landmark's AUM, the associated fee revenue and EBITDA earnings are more stable because they are primarily based on committed capital, not mark-to-market investment value. For the remaining assets, pricing inputs are generally unobservable and require significant management judgment or estimation because there is little, if any, market activity associated with them. Additionally, given the nature of Landmark's investment products, fee rates are high, investors in them are locked up for many years and outflows are predictable. By contrast, traditional equity fund investments are generally low fee and feature open-ended structures, thus making redemption behavior among investors more unpredictable.

Organic AUM growth across BSIG's remaining traditional equity-oriented affiliates has been solid, in the low-single-digit percentage-point range since 2016. However, Landmark has had much higher AUM growth, 17% annually since 2016, and the company's future growth expectations are high because of surging demand. Post-sale, BSIG will have fewer growth opportunities.

Pro forma balance sheet liquidity will improve to approximately $1 billion from $402 million at year-end 2020, compared to just $400 million in outstanding debt. We expect use of after-tax sale proceeds of $630 million by BSIG to be balanced between creditor interests, such as deleveraging the balance sheet, and shareholder interests.

BSIG's sale of Landmark follows the company's February 2021 announced sale of Investment Counselors of Maryland, which is an equity oriented affiliate with $3 billion in AUM as well as the sales of Barrow Hanley and Copper Rock, both equity oriented affiliates with combined AUM of $42 billion, in 2020.

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Continued economic recovery points to higher rising star rate in 2021

Originally published on 06 April 2021

Summary

Corporate credit trends are poised to improve as the global economy recovers from the shock of the COVID-19 pandemic, which is leading to increased investor attention on the potential for rating upgrades in 2021. In particular, focus is growing on companies with potential to be upgraded to investment grade from speculative grade (rising stars). In this report, we provide our forecasts for rising star rates with a focus on Ba1 issuers, which are companies rated just below investment grade and are the most likely to be upgraded from speculative grade.[1] Key findings are:

» **We project that the Ba1 rising star rate will rise to 11.9% for the trailing 12 months ending in July 2021**. This forecast compares with a Ba1 rising star rate of 3.4% for the trailing 12 months ended in July 2020, which we expect to be the lowest level in the COVID-19 credit cycle.[2] Our forecast, if realized, will be in line with the patterns after both the 2001 and 2008 recessions, as Exhibit 1 shows.

» **Sectors most exposed to the pandemic will likely have the lowest Ba1 rising star rates over the coming year**. We expect industries with high exposure to COVID-19 disruption to have a 4.6% rising star rate for the 12 months ending in February 2022. In contrast, we expect the moderate- and low-exposure industries to have higher Ba1 rising star rates, at 13.9% and 14.7%, respectively.

Exhibit 1
We forecast that the Ba1 rising star rate will surge to 11.9% by July 2021 following pattern seen after previous recessions

Source: Moody's Investors Service

For inquiries on the underlying data, please contact ClientServices@moodys.com.

We forecast that the trailing 12-month Ba1 rising star rate will surge to 11.9% a year after its trough in July 2020

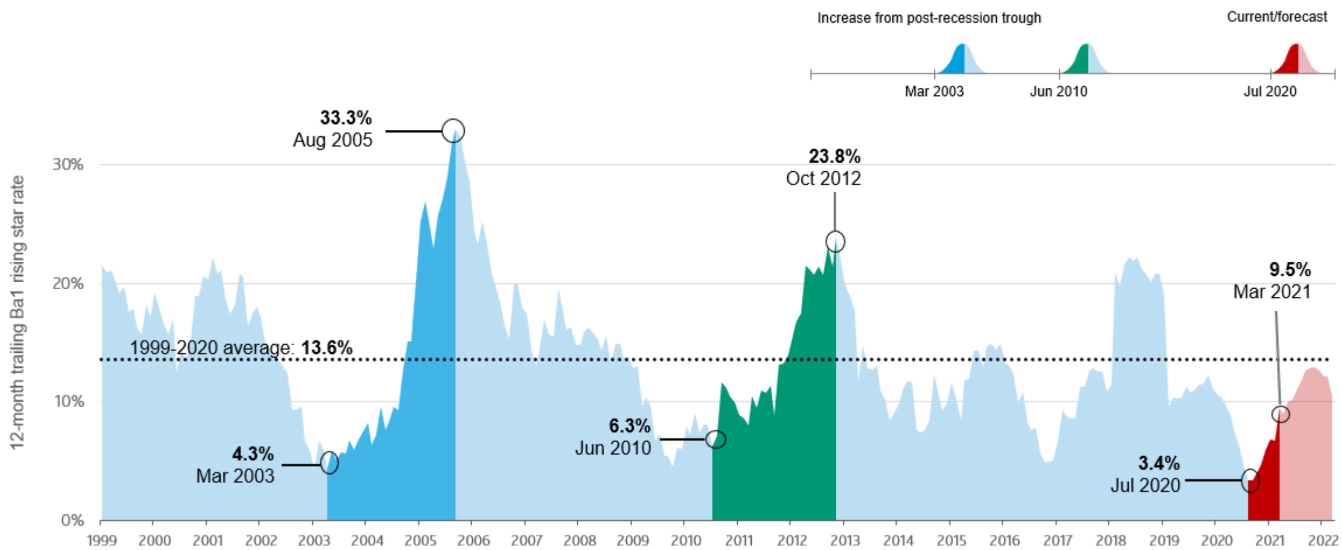
The coronavirus pandemic triggered a global recession and led to an increase of rating downgrades and a slowdown of upgrades in 2020. As the pandemic threat recedes and economic conditions improve, we expect more rating upgrades in 2021 than in 2020. In particular, we forecast an increase in the rising star rate.

Exhibit 2 plots the rising star rate for Ba1 issuers, the most likely to be upgraded to investment grade, since 2000. We highlight their behaviors after the recessions in 2001, 2008 and 2020. As shown in the chart, the trailing 12-month Ba1 rising star rate fell to 3.4% in July 2020, which we expect to be the lowest level in the COVID-19 credit cycle. In comparison, the pre-crisis rising star rate was around 12%.

Our Credit Transition Model (CTM)[3,4] predicts that the rising star rate for Ba1 issuers will rise to 11.9% by July 2021. This forecast, if realized, will be in line with the patterns after both the 2001 and 2008 recessions, when the comparable rate climbed to roughly 10% a year after the post-recession troughs of 4.3% and 6.3%, respectively. The model further indicates that the Ba1 rising star rate may reach a temporary peak in the fourth quarter of 2021. However, it is premature to call that a cyclical peak. As shown after the prior two recessions, the upward path from trough to peak has been non-monotonic, evolving over a period in excess of two years. If the rate continues to follow the behaviors after the last two recessions, it could rise further into 2022.

Exhibit 2

After bottoming at 3.4% in July 2020, the Ba1 rising star rate will be on a rising track in 2021

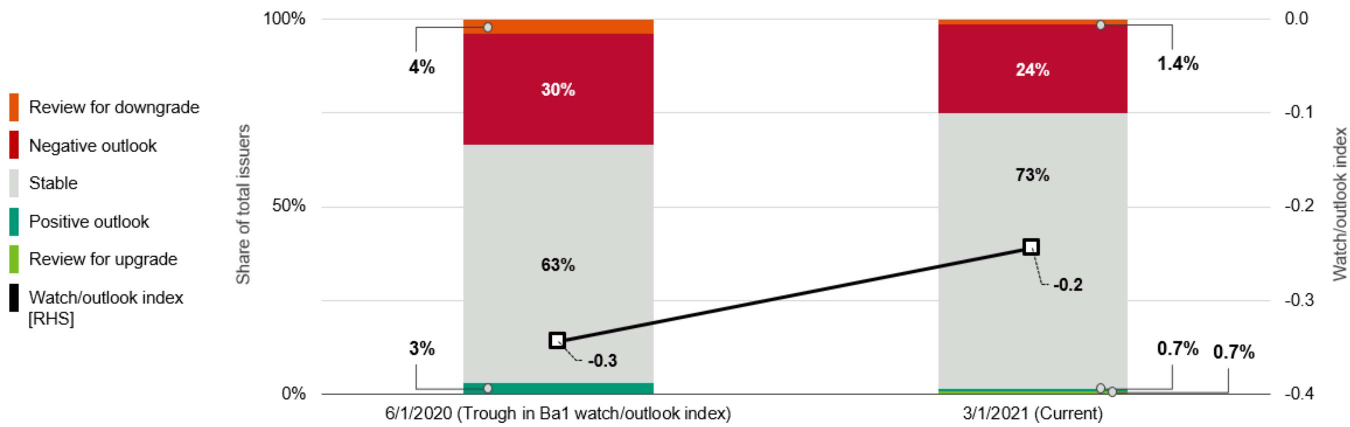


Source: Moody's Investors Service

The above forecasts incorporate our assumptions of a continued economic recovery and ongoing accommodative monetary policies. Moreover, they reflect the improved distribution in watchlist and outlook assignments for Ba1 issuers from their low point in 2020 (see Exhibit 3). In addition to comparing the distribution of five watchlist/outlook assignments, we also indicate the improvement in watchlist/outlook assignments through the watch/outlook index, a single metric that summarizes the watchlist and outlook designations for all the issuers in a given cohort.[5]

Exhibit 3

Improving Ba1 watch outlook distribution may drive upward trend in Ba1 rising star rate



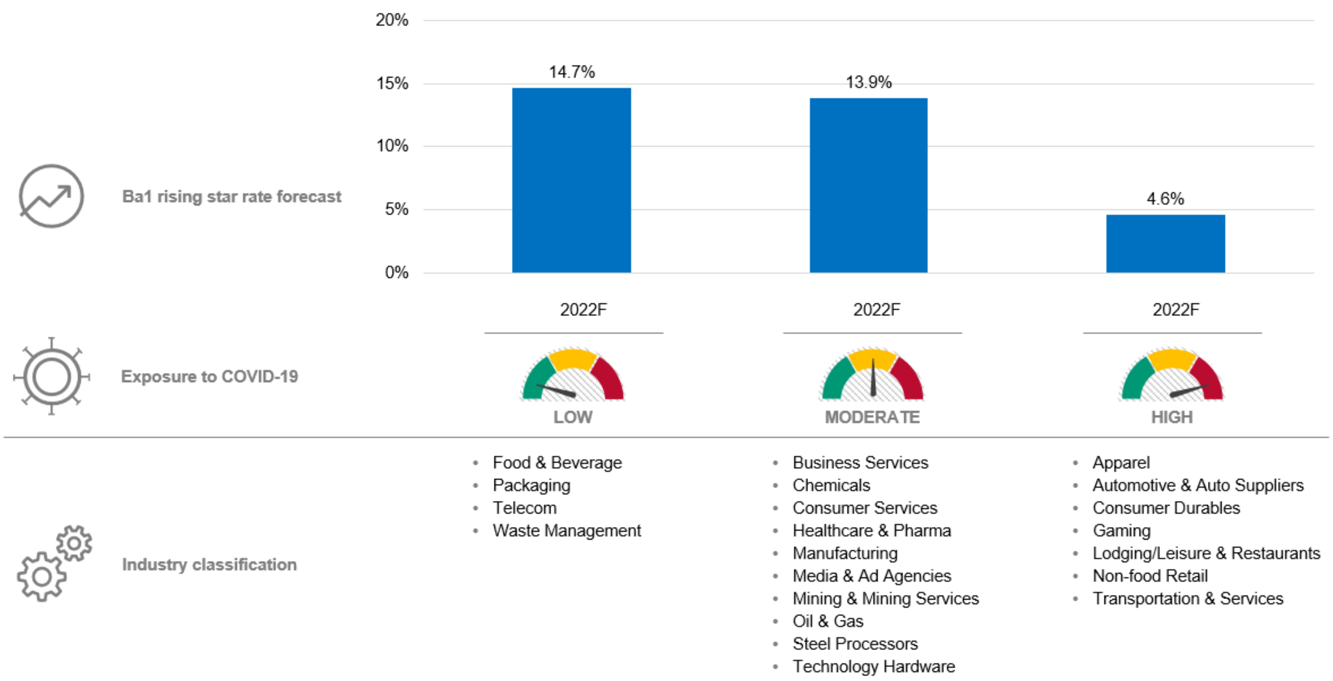
Source: Moody's Investors Service

Ba1 rising star rate will be higher for moderate and low-exposure industries in the coming year

In this section, we look at rising star rate forecasts for industry groupings broken out by our analysts' classification of industries according to their exposure to virus-induced disruption. We classify industries based on high, moderate or low exposure to the pandemic, using the global and North America coronavirus heat maps we developed last year.[6] We classify an industry as having a high exposure to pandemic disruption only if both heat maps have classified it as such. We take a similar approach to the moderate- and low-exposure categories.

Exhibit 4

Industries with moderate and low exposure to the pandemic are expected to have higher Ba1 rising star rates for the 12 months ending in February 2022



The forecast aggregate Ba1 rising star rates are closely aligned with our initial assessment of sector exposure to the pandemic in March 2020, although some of these levels of exposure and our industry outlooks have changed over time.
Source: Moody's Investors Service

The high-exposure industries are expected to have the lowest Ba1 rising star rate, at 4.6%, for the 12 months ending in February 2022 (see Exhibit 4). In contrast, moderate- and low-exposure industries are expected to have higher Ba1 rising star rates of 13.9% and 14.7%, respectively, at that time.

The lower forecast rising star rate for high-exposure industries reflects the fact that although the pandemic is abating, these industries in aggregate are yet to recover from the impact of COVID-19. On the other hand, moderate- and low-exposure industries are showing better recovery prospects currently, as reflected in the additional related metrics shown in Exhibit 5. For example, moderate- and low-exposure industries have a higher share of Ba1 issuers within their speculative-grade universe, at 5.0% and 3.8%, respectively, compared with 1.6% for high-exposure industries. Similarly, moderate- and low-exposure industries have a larger percentage of potential rising stars[7] and a more favorable watch/outlook index than high-exposure industries.

Exhibit 5

Moderate- and low-exposure industries have better rising star-related metrics as of March 2021

COVID-19 risk-exposure group	Share of Ba1 in SG	Share of potential rising stars in Ba1	Ba1 watch/outlook index
Low	3.8%	8.3%	0
Moderate	5.0%	11.9%	-0.1
High	1.6%	0.0%	-1

Source: Moody's Investors Service

Endnotes

1 Unless otherwise specified, ratings in this report refer to issuer level, senior unsecured or equivalent ratings, which are derived from Moody's Senior Rating Algorithm (pages 16-20). This algorithm uses available ratings information to generate an estimated senior unsecured rating if one is not explicitly outstanding. In this report, issuers refer to individual companies, not corporate families.

2 The universe of issuers included in this study consists of nonfinancial companies that have long-term debt ratings excluding infrastructure, sovereign, project finance and utilities issuers.

3 CTM is a discrete time, multiple-destination and proportional-hazards model that we use to predict an issuer's probability of rating transition, including being in default. For details, see Introducing Moody's Credit Transition Model, August 2007.

4 To generate the Ba1 rising star rate forecasts, the model incorporates various rating factors such as rating momentum, distribution of watchlist/outlook assignments and change of watchlist/outlook status. In addition, the model also takes into consideration the future path of two economic drivers: the high yield spread and change in unemployment rate.

5 Mathematically, the watch/outlook index is calculated via two steps. First, we assign the following weights to each issuer in a particular cohort: +2 if on review for upgrade, +1 for a positive outlook, -1 for a negative outlook, and -2 if on review for downgrade. Second, we divide the sum of these weights by the total number of issuers in the cohort.

6 For the definition of our global coronavirus heat map, see Heat map: Coronavirus hurts travel-driven sectors, disrupts supply chains, effects compounded with global spread, March 16, 2020. For the definition of North America coronavirus heat map, see Heat map: Worsening coronavirus outbreak means broader negative credit effects, April 3, 2020.

7 Potential rising stars are defined as Ba1-rated issuers that are on review for upgrade or have a positive outlook.

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CREDIT IN DEPTH

Sovereign default and recovery rates, 1983-2020

Originally published on 07 April 2021

In our 17th annual report on sovereign bond defaults and rating histories, we focus on defaults of Moody's-rated sovereign bond issuers in 2020. We also update the default, loss and rating transition experience of rated sovereigns over the 1983-2020 period. Highlights of this study are:

» **The COVID-19 pandemic has materially worsened sovereign fiscal and external balances across the globe.** The virus outbreak exacerbated weak external positions in a few countries and prompted several to seek liquidity relief through debt restructuring as borrowing requirements rose significantly and funding sources dwindled because of the pandemic shock. The annual sovereign bond default rate spiked in 2020, reaching its highest level since 1983. We observed six defaults during the year, including Lebanon (C no outlook), Ecuador (Caa3 stable), Suriname (Caa3 negative), Belize (Caa3 stable) and Zambia (Ca stable), as well as Argentina (Ca stable) following the default on short-term debt in 2019.

» **The unprecedented increases in debt levels globally will represent a lasting legacy of the pandemic shock.** Managing debt trajectories will be key for both emerging and advanced economies with relatively high debt burdens in the coming years. Debt affordability, access to international capital markets and the depth of domestic funding bases will be critical points of differentiation for sovereigns. Further international initiatives will likely support the most vulnerable countries, and the focus will intensify on the frameworks for sovereign debt restructurings.

» **Sovereign recovery rates have varied considerably.** Issuer-weighted recovery rates on defaulted sovereign bonds, as measured by trading prices around the time of default, averaged 53% overall over the 1998-2020 period. However, sovereign recovery rates differed significantly, ranging from 17% to 95%.

» **Sovereign ratings have been predictive in differentiating defaulters from non-defaulters**. Since 1983, sovereigns that defaulted had a lower rating than 94% of rated sovereigns in the year prior to default. The median rating 12 months before default was B3 and the median rating five years before default was B2.

Click here for the full report.

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Corporates

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» Zacapa's term loan B add-on strengthens liquidity, a credit positive despite increased leverage

» China's debt guidance is credit positive for enterprises owned by local governments

» Shanghai Electric's proposed nonpublic placement is credit positive

» Fire at Pertamina's Balongan refinery raises social risks, a credit negative

» 21Vianet's share repurchase increases pressure on liquidity profile, a credit negative

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Banks

» Access Bank's acquisition of Grobank stake supports its plan to be a gateway for trade and payments in Africa

» Launch of interoperable QR payment link between Vietnam and Thailand is credit positive

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» Proposed rule reform would improve EU money market funds' tolerance of extreme market stress

Sovereigns

» Additional spending is set to mitigate pandemic-related scarring of Germany's economic strength

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CREDIT IN DEPTH

» Post-pandemic labour market dynamics for women will amplify credit strengths and challenges

Click here for the 1 April 2021 Credit Outlook.

Editors

Jay Sherman, Elisa Herr, Andrew Bullard, Julian Halliburton and Phil Macdonald

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